SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK
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MAZEL CAPITAL, LLC, on its own behalf, and derivatively on behalf of HEARTWATCH, LLC

Index No. 600592/10

Plaintiff,

I.A.S. Part 54
Motion #6

-against-

FRANKLYN LAIFER,

Defendant.

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PLAINTIFF'S MEMORANDUM OF LAW IN OPPOSITION
TO DEFENDANT'S MOTION FOR SUMMARY JUDGMENT

Plaintiff Mazel Capital, LLC ("MC") submits this memorandum of law in opposition to defendant Franklyn Laifer's ("Laifer") motion for summary judgment.

Laifer's core arguments are that MC knew, or should have known, about Laifer's breach of the Operating Agreement's (Exhibit "A" to Jedwab Aff.) prohibition against his receipt of any compensation; that Laifer's actions concerning his authorization of payments to consultants are protected by the business judgment rule; that MC failed to object to defendant's breaches and waived its claim of breach; and that MC is not entitled to punitive damages and attorneys' fees.

The facts, however, establish that MC was fraudulently induced by Laifer into making multiple investments in Heartwatch, a New York LLC founded by Laifer, who served as the company's only Manager. Immediately after MC's initial investment in Heartwatch in May, 2006, Laifer breached the terms of a Letter Agreement (Exhibit "B" to Jedwab Aff.) between

Laifer and MC, and simultaneously breached the terms of Heartwatch's Operating Agreement. Laifer's breaches included, *inter alia*, authorizing illegal compensation to himself totaling at least $498,640, paying excessive compensation to Heartwatch consultants totaling at least $330,563, and exceeding the monthly spending restrictions during the first six months following MC's initial investment, which included $113,500 in illegal payments to Laifer.

In addition, Laifer failed to disclose his self-dealing while providing incomplete and misleading information to MC concerning Heartwatch's finances and business operations. When MC's members eventually learned about Laifer's illegal allocation of funds, they instructed Laifer to adhere to the terms of the Operating Agreement, which included a cessation of any compensation to Laifer and of any other improper allocations as Manager of Heartwatch.

In response to MC's instructions, Laifer misrepresented that he would exercise due care and not make improper and excessive spending, including payment of hundreds of thousands of dollars to himself. These misrepresentations induced MC to make additional investments in Heartwatch in May, 2007, totaling $120,000 and in October, 2007, totaling $180,000. Despite MC's total investment of $550,000 in cash capital contributions and $300,000 in the transfer of MC's investment in EK Guard (along with an additional $650,000 in capital contributions from other minority shareholders), Heartwatch failed to generate even a single client or dollar in revenue. Ultimately, when Heartwatch's investors refused to pour any more money into the company because of Laifer's multiple breaches, the company closed in 2008.

PRIOR PROCEEDINGS

This action was originally brought on March 8, 2010 after Laifer repeatedly and unjustifiably refused to provide certain financial information to plaintiffs concerning

HeartWatch. Plaintiff initially moved by Order to Show Cause to compel Laifer and Heartwatch to produce that information, and only after that motion was made did they reluctantly provide that information. The complaint was subsequently amended to assert causes of action against Laifer and Heartwatch for breach of the Operating Agreement and fraud. Defendants moved to dismiss the complaint, asserting that the claims were derivative in nature. The Court granted plaintiff leave to amend the complaint to assert a derivative claim for breach of the operating agreement as well as a fraud claim asserted on behalf of MC. As noted in the complaint, in September, 2009, after HeartWatch failed, plaintiff requested HeartWatch's financial information. Instead of provided access to HeartWatch's records, in December, 2009, plaintiff was given unsigned copies of tax returns. Further requests were made, but to no avail. It was not until after plaintiff moved by Order to Show Cause to compel defendants to produce the requested information, that they reluctantly made such information available to plaintiff's counsel.

Thereafter, defendant moved to have the caption amended to remove Heartwatch as a defendant and to allow Feder Kaszovitz, LLP ("Feder"), the attorneys who represented Heartwatch, to be relieved as counsel for Heartwatch. Plaintiff cross-moved to have Feder disqualified from representing Laifer as it was a conflict to represent a shareholder when Feder had already acted as counsel to Heartwatch. The Court granted Laifer's motion and directed that the caption be amended, allowed Feder to withdraw and denied plaintiff's motion to disqualify Feder. Discovery ensued and Laifer has submitted the instant motion for summary judgment

THE COMPLAINT

This action arises out of Laifer's total disregard of his obligations to MC as manager, his violations of statutory requirements and his duties to Heartwatch and MC. MC brings this action on its own behalf and on behalf of Heartwatch.

The complaint alleges two causes of action. In the first cause of action, a derivative claim, the Complaint alleges that Laifer breached the Operating Agreement and personally gained from such breach when he paid himself substantial compensation in violation of the express terms of the Operating Agreement.

In the second cause of action the complaint alleges that, Laifer engaged in fraud as he failed to disclose to MC, and in fact intentionally concealed the fact that he paid himself almost $500,000.00 between 2006 and 2008. Because MC was unaware of Laifer's misapplication of such funds and misconduct, and based on Laifer's representations that the funds would be used for working capital and not for the personal benefit of Laifer, MC invested the additional sums of $120,000 in May, 2007 and $180,000 in October, 2007. Had MC been aware of the true facts – that Laifer was paying himself out of Heartwatch's funds, making excessive, unjustified and unreasonable payments to consultants, then plaintiff would not have made such investments in Heartwatch and would have demanded the return of its initial investment.

FACTS

The facts are set forth in the accompanying affirmation of Richard Jedwab, the managing member of MC ("Jedwab Aff.") In 2006, Laifer founded Heartwatch and controlled a 100% membership interest in the company. On May 24, 2006 Laifer and MC executed an Operating Agreement (Exhibit A to Jedwab Aff., "the Operating Agreement") and Letter Agreement (Exhibit B to Jedwab Aff., "Letter Agreement"). Pursuant to the Letter Agreement MC agreed to transfer and assign to Heartwatch all of its interest and rights in another company (E.K. Guard, Inc.) which interest was valued at $300,000, and in exchange for this transfer MC received a 5% membership interest in Heartwatch. MC also made a $250,000 cash capital investment in Heartwatch for an additional 4% membership interest in the company, thus bringing MC's then-membership interest in Heartwatch to 9%, while Laifer's membership interest was reduced to 91%.

Ultimately, MC held a 12% membership interest in Heartwatch after investing $550,000 in capital funding and $300,000 in its membership interest in E.K. Guard, Inc. Heartwatch's other owners included South Ferry Building Co., which invested $500,000 and held a 6.5% membership interest; Alan Laifer (Laifer's son), who invested a total of $100,000 for a 1% membership interest; and Seymour Kramer, who invested $50,000 for a 0.5% membership interest. (Jedwab Aff., para. 3)

Franklyn Laifer invested no funds in Heartwatch and ultimately retained an 80% interest in the company. (*Id.*) Although none of Heartwatch's members received any distributions (due to the company's failure to generate any form of revenue) Laifer, as Managing Member, nevertheless authorized at least $498,640 in payments to himself as the Manager of the company during its brief existence between 2006 and 2008. (Jedwab Aff., para. 9, See also General Ledgers, annexed to the Jedwab Aff. as Exhibits C, D, & E)

The management of Heartwatch was governed by the company's Operating Agreement. Article III, paragraph 7 of the Operating Agreement stated: "The management of this Company shall be vested in the Manager," and paragraph 7(a) stated: "The Manager shall not be entitled to any compensation for serving as Manager to this company (exclusive of any distributions made to such Manager in his capacity as a member)." (Jedwab Aff., para. 6)

Article VII, paragraph 2 of the Operating Agreement stated: "No failure of a member to exercise and no delay by a member in exercising any right or remedy under this Operating Agreement shall constitute a waiver of such right or remedy. <u>No waiver by a member of any such right or remedy under the Operating Agreement shall be effective unless made in writing duly executed by all members and specifically referring to each such right or remedy being waived.</u>" (Jedwab Aff., para. 7) At no point did MC ever waive any of its rights or remedies in the Operating Agreement. (Jedwab Aff., para. 12)

Article VII, paragraph 3 of the Operating Agreement stated: "<u>No Amendment of this Operating Agreement shall be effective unless made in writing duly executed by all members and specifically referring to each provision of this Operating Agreement being amended.</u> No course of conduct or performance subsequently pursued or acquiesced in and no oral agreement or representation subsequently made, by the members, whether or not relied or acted upon, shall amend this Operating Agreement or impair or otherwise affect any member's obligations, rights or remedies pursuant to this Operating Agreement." (Jedwab Aff., para. 8) No Amendments to the Operating Agreement were ever duly executed by Heartwatch's members. (Jedwab Aff., para. 11-13)

The terms of the Operating Agreement are clear and unambiguous No written Waivers or written Amendments of the Operating Agreement were ever authorized or executed by MC (or, for that matter, by any of Heartwatch's members). Accordingly, Laifer was not authorized to pay himself as Manager of Heartwatch.

Likewise, the terms of the Letter Agreement are clear and unambiguous. Paragraph 5 of the Letter Agreement stated: "Mazel acknowledges and agrees that the Investment will be used by Heartwatch for any and all legal working capital purposes, including, without limitation, for general start-up costs such as rent, salaries, utilities and other day-to-day expenses, provided, however, that Heartwatch hereby undertakes that, unless it receives the prior written consent of Mazel, it will not use in excess of $50,000 per month for each of the first two months, and $37,500 per month for each of the following four months, from the date of the Investment (so that the Investment will not be fully expended for a period of at least six (6) months from the date of the Investment)."

Laifer claims that he was not in breach of the Letter Agreement because Heartwatch did not spend more than $250,000 (i.e. MC's initial capital contribution) during the company's first six months of operations following MC's investment. Nevertheless, Laifer siphoned off $113,500 in compensation to himself from MC's initial investment during these first six months. This compensation, which was not even characterized as salary, did not qualify as "legal working capital purposes" and, therefore, Laifer is in breach of the Letter Agreement.

In an attempt to circumvent his obligations under the Operating Agreement and Letter Agreement and evade culpability for his breaches, Laifer now claims, quite astonishingly, that the compensation he authorized for himself was not for his role as Manager, but rather for his role as Medical Director of Heartwatch. In all of Laifer's communications and emails on behalf of Heartwatch, and in all of Heartwatch's literature (the production of which Laifer supervised), Laifer represents himself as either Manager or CEO.

Laifer's responsibilities as Manager of Heartwatch included overseeing all aspects of the company, including managing both the medical and non-medical staff and operations. (Jedwab Aff., para. 16) The Operating Agreement made no distinction between his duties as purported medical director and managing member. This included supervising the medical team as well as the sales team, setting up the call-center as well as the administrative office, overseeing the company’s finances as well as its medical equipment and technology, approving the marketing materials and information literature, cultivating new investors, and so on. Not only was Laifer in charge of the entire company as its Manager, but also he was the only Member Manager, which means he was in complete control of the company’s day-to-day affairs without any hands-on involvement in the company by any of the other shareholders. All of Heartwatch’s employees and consultants worked for Laifer, and all company decisions went through him, including the hiring of employees. It defies logic that Laifer, as head of the entire company, would hire himself to serve in a position that reported to the Manager. Indeed, the Operating Agreement expressly described Laifer’s duties as Manager, as being so broad as to clearly encompass his newly concocted responsibilities as “Medical Director.”

Moreover, by Laifer’s own account, Heartwatch’s Medical Director was Dr. Howard Goldsmith and not Laifer

> **Question**: Is it fair to say that Heartwatch lists Dr. Goldsmith as its Medical Director?
>
> **Answer**: Dr. Howard Goldsmith functioned in a different capacity than what I functioned as so if I misspoke, and <u>**I wasn’t the medical director**</u>, I was the medical person for the company who was the fully trained medical person. Howard Goldsmith had one role for Heartwatch, okay, which was through a company that we formed to deal with the medical aspects of Heartwatch, because at a point in time when we moved forward Heartwatch was not going to be able to function and be able to provide medical services and be compensated for that so in my role as medical director, medical

> advisor, medical guru, whatever you want to call it, I got involved in several areas of putting this together. (emphasis added)
>
> (Jedwab Aff., para 21, Exhibit H)

Recognizing that he was not entitled to be compensated as Manager, Laifer has concocted a claim that he was nevertheless entitled to pay himself as "Medical Director". Nor did Laifer request or receive authorization from MC to hire himself as Medical Director/Advisor/Guru and compensate himself accordingly. It is disingenuous for Laifer to now put forward that he simultaneously held two positions in Heartwatch, the first as Manager of the entire company, and the second as Medical Director/Advisor/Guru, a job whose functions, Laifer asserts, fell outside the parameters of his role as Manager and warranted compensation of close to $500,000. This self-dealing is a violation of the spirit and letter of the Operating Agreement and Letter Agreement prohibiting Laifer's compensation as Manager.

Further still, Laifer authorized payments totaling more than $94,000 to a company called Aerotel in exchange for approximately 1,000 fully operational heart monitoring devices. While none of these devices were ever sold, Laifer nevertheless cannot account for the whereabouts of this valuable equipment. (See Exhibit H, pp. 96:20-97:7)

Lastly, Laifer alleges that he did not defraud MC into making additional investments in Heartwatch in May and October of 2007 because, according to Laifer, MC was fully informed of Heartwatch's spending and of Laifer's compensation. Laifer contends that MC received regular written reports about Heartwatch's finances, yet the record reflects only sporadic reporting from Heartwatch. MC received only one written expense report between May 2006 and August 2006. This document consisted of a one-page spreadsheet that, *inter alia*, listed "Frank Fees" in connection with the compensation paid to Laifer. No further description concerning the nature of any payments to Laifer was provided in the document. The next time MC received a written expense report appears to be in late February, 2007, which contained a single-page spreadsheet similar to the one provided in August, 2006. Neither the August, 2006 document nor the February, 2007 document contains any mention of waivers or any discussion about authorization by Heartwatch Members to Amend the Operating Agreement in order to allow for the compensation of Heartwatch's Manager.

The only other written financial materials provided by Heartwatch to MC between August, 2006 and July, 2007 appear to consist of business plans containing projected (not actual) income and expenses. For example, The 2006 Business Plan projected that Heartwatch would have 5,904 paying customers by 2007 generating $2,759,314 in revenue; 24,000 paying customers by 2008 generating $16,261,514 in revenue; and 95,000 paying customers by 2010 generating $67,277,125 in revenue. Laifer now suggests that MC should have anticipated Laifer's compensation based on the line-item inclusion of compensation for Heartwatch "Mgmt and Operations Salaries" in the forecasted budgets. But the projections and timetables in these reports are conjecture and pure fantasy. They estimate a rapid ramp-up resulting in tens of thousands of customers and tens of millions of dollars in revenue within only a few years, which obviously never occurred. Under no circumstances could MC have been expected to rely on these documents and their hyper inflated forecasts to anticipate, among other matters, Laifer's receipt of excessive and unauthorized compensation.

Laifer refers to three draft versions of offering materials dated March, 2007, which contemplated salaries for employees, officers and directors. Yet these materials are irrelevant for consideration here, as they were not only unsigned, but they contained mere projections and were not incorporated in any of the agreements between MC and Heartwatch. Laifer also sent to MC a series of Business Updates involving one to three page reports dated July 25, Aug. 1, Aug. 16, and Sept. 25, 2007. Upon first glance, these Business Updates depict a very positive picture of Heartwatch and the successes it claimed to have achieved in setting up a call center, securing hospital affiliations, offering trial programs for patients, developing physician programs, expanding its sales force, setting up operations, expanding its marketing and PR, and implementing its human resources policies. But upon closer inspection, these Business Updates are virtually identical to one another except for the scheduled launch date of Heartwatch's call center, which is progressively pushed back from September 10, 2007 to October 15, 2007 to November 12, 2007. Moreover, these Business Updates offer no financial reporting of actual Heartwatch expenditures.

Laifer also cites various phone calls and meetings with MC's members in which Heartwatch expenditures were discussed. Notably, MC voiced concern to Laifer concerning Heartwatch's burn-rate. During those discussions, which occurred approximately around the time of MC's Additional Investments, MC members specifically told Laifer that he needed to better control Heartwatch's expenses. This included instructions to Laifer to adhere to the terms of the Operating Agreement, which prohibited compensation to Heartwatch's Manager. In response to MC's demands, Laifer promised that he would control Heartwatch's expenses and abide by the terms of the Operating Agreement. Based on these representations, Laifer induced MC to fund Additional Investments in Heartwatch totaling $120,000 in May, 2007 and $180,000 in October, 2007. (Jedwab Aff., para. 24) Yet despite Laifer's representations to control Heartwatch's expenses and comply with the Operating Agreement, he continued to authorize illegal compensation to himself and excessive compensation to Heartwatch's consultants. [1]

POINT ONE

PLAINTIFF REASONABLY RELIED ON DEFENDANT'S REPRESENTATIONS TO ADHERE TO THE TERMS OF THE AGREEMENTS

Laifer alleges that MC cannot prove reasonable reliance in its fraud claim because MC knew about Laifer's compensation and spending authorizations concerning consultants, and/or had access to information that would reveal these expense authorizations.

To establish a cause of action for fraud, the petitioner must establish the following elements: (1) misrepresentation of a material fact; (2) scienter; (3) justifiable reliance; and (4) injury or damages (*see, Gouldsbury v. Dan's Supreme Supermarket*, 154 A.D.2d 509, 546 N.Y.S.2d 379 (2nd Dept. 1989); *Brown v. Lockwood*, 76 A.D.2d 721, 731, 432 N.Y.S.2d 186 (2nd Dept. 1980); *Matter of Garvin*, 210 A.D.2d 332, 620 N.Y.S.2d 400 (2nd Dept., 1994); *Ross v Louise Wise Servs*., Inc., 8 NY3d 478, 488 (2007*); Lama Holding Co. v Smith Barney*, 88 NY2d 413, 421 (1996). *Eurycleia Partners, LP v Seward & Kissel, LLP*, 12 N.Y.3d, 553 (2009).

Here, Laifer fraudulently induced MC to provide additional investments to Heartwatch totaling $120,000 in May, 2007 and $180,000 in October, 2007, by intentionally misrepresenting to MC he would, in fact, fulfill his representations and not pay himself hundreds of thousands of dollars. As a result of Laifer's actions, MC lost its entire investment in Heartwatch totaling $550,000 in cash and its $300,000 in membership interest in E.K. Guard, Inc. A contractual

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Laifer also relies upon statements made by Hirsch Wolf, a deceased member of MC. Wolf had no authority on behalf of MC as he was not the managing member, but it speaks volumes about Laifer's conduct when he seeks to rely upon uncorroborated conversations with a deceased investor. No such conversations are alleged between Laifer and Jedwab, MC's managing member.

promise made with the undisclosed intention not to perform it constitutes fraud. *Sabo v. Delman*, 3 N.Y.2d 155, 164, N.Y.S.2d 714 (1957); *Manufacturers and Traders Trust Co., v. Cottrell*, 71 A.D.2d 538, 433, N.Y.S.2d 990 (4th Dept., 1979). Laifer attempts to use the materials he sent to MC and the conversations he had with its members to discredit MC's reliance on Laifer's misrepresentations concerning his compensation and expenditures. To support his claim, Laifer relies on *Stuart Silver Associate, Inc. v. Baco Development Corp.*, 245 A.D.2d 96, 665 N.Y.S.2d 415 (1st Dept., 1997)

(concerning a dispute over projected income and expenses in the prospectus for a real estate transaction in which plaintiff and defendant were partners); *KNK Enterprises, Inc. v. Harriman Enterprises, Inc.*, 33 A.D.3d 872, 665 N.Y.S.2d 415 (1st Dept. 2006) (where plaintiff entered into a transaction despite knowing that it had not received full information concerning the transaction); and *Accord Assured Guaranty Municipal Corp. v. DLJ Mortgage Capital, Inc.*, 44 Misc.3d (1206(A)), 2014 N.Y. Slip Op. 51044(U), (Sup. Ct., N.Y. Co. 2011) (concerning risk that plaintiff specifically bargained to assume involving mortgage-backed securities transactions).

Unlike in *Stuart Silver Associates, supra* MC does not allege fraud based on its reliance on Laifer's representations in Heartwatch's prospectus materials, but rather upon Laifer's representations in person and in the Operating Agreement that was already in effect at the time of MC's additional investments in May and October, 2007. *KNK Enterprises, Inc., supra* and *Accord Assured supra*, do not apply here because MC reasonably relied on Laifer's representations in the existing Operating Agreement, which was comprehensive and specific concerning such matters as the prohibition of compensation to Heartwatch's Manager.

Defendant further relies on a series of cases involving real estate transactions that are each distinguishable from the instant action. In *Afra v. Zamir*, 78 A.D.3d 56, 905 N.Y.S.2d 77 (1st Dept., 2010), the general releases in a real estate contract prevented plaintiff from proving fraud even though defendant misrepresented the condition of the building being purchased. In *Rosenblum v. Glogoff*, 96 A.D.3d 514, 946 N.Y.S.2d 167, (1st Dept., 2012) a merger clause in the agreement precluded plaintiff from relying on defendant's material misrepresentations concerning the physical condition of a co-op unit under contract with a time-of-the-essence closing. Here, Laifer continued his fraudulent conduct after the Operating Agreement was signed and additional investments were made by MC. In *Miller v. Icon Grp. LLC.*, 77 A.D.3d 586, 911 N.Y.S.2d 3 (1st Dept., 2010) after acknowledging that it examined all matters related to a real estate transaction, defendant could not then claim to have been fraudulently induced to purchase property based on false representations it received that the adjacent property was also available for sale to the defendant. In *Holzer v. Mondadori*, 40 Misc. 34d 1233(A), 980 N.Y.S.2d 276 (Sup. Ct. N.Y. Co. 2013) (Kornreich, J.), this Court dismissed a fraud claim where plaintiff signed a purchase agreement that contained a merger clause explicitly disclaiming any reliance on representations not contained in the real estate contract, where in this case defendant made misleading representations to plaintiff <u>after</u> the Operating Agreement was signed and additional investments were made.

Defendant also relies upon *Dragon Investment Co. 11 LLC v. Shanahan*, 49 A.D.3d 403, 854 N.Y.S.2d 115 (1st Dept., 2008); *UST Private Equity Investors Fund, Inc. v. Salomon Smith Barney*, 288 A.D.2d 87, 733 N.Y.S.2d 385 (1st Dept. 2001) and *Wong v. May*, 23 Misc.3d 1114(A), 886 N.Y.S.2d 69 (Sup. Ct. N.Y. Co. 2009), cases which allege fraud prior to the execution of the investment agreements. Here, MC made false representations after the execution of the agreements which led plaintiff to make further investments in Heartwatch, which funds substantially found their way directly into Laifer's pocket.

POINT TWO

THE BUSINESS JUDGMENT RULE DOES NOT APPLY IN MATTERS INVOLVING SELF-DEALING

Laifer next argues that the business judgment rule bars judicial inquiry into his decision as Manager to pay compensation to himself as well as exorbitant consulting fees, alleging his decisions were made in good faith and served proper business purposes.

Laifer asserts that his decision to pay compensation to Heartwatch's consultants, which, by his own logic would have to include the almost $500,000 in payments to himself as Heartwatch's "Medical Director," are shielded from scrutiny by the courts because of the business judgment rule. However, a defendant's fraudulent self-dealing is not protected under the business judgment rule. "The business judgment rule does not protect corporate officers or partners who engage in fraud or self-dealing, or corporate fiduciaries when they make decisions affected by an inherent conflict of interest (*Wolf v. Rand*, 258 A.D.2d 401, 404, 685 N.Y.S.2d 708 (1st Dept.1999). Here, Laifer authorized compensation to himself in direct contravention of the Operating Agreement and the Letter Agreement. He leveraged his authority as Manager of Heartwatch to authorize payments to himself that he had no right to receive. He improperly took money from the company and violated the trust placed in him as a fiduciary of the company.

Laifer claims that he did not breach his fiduciary duty not to waste corporate assets by spending more than $330,000 on consultants between 2006 and 2008 (in addition to the more than $498,000 in compensation he authorized to himself). Laifer goes so far as to claim that he had the greatest interest in ensuring that Heartwatch did not pay excessive employee compensation because he owned 80% or more of the company. Despite his supermajority interest in Heartwatch, however, Laifer provided $0 in capital contributions to the company. Thus, not a penny of Laifer's more than $498,000 in compensation to himself or the more than $330,000 in payments to consultants came out of Laifer's own pockets, but rather from the pockets of Heartwatch's minority investors (who never received any distributions from the company due to its failure to generate any revenue). MC is left to wonder whether any of its investments were used for legitimate purposes. In such circumstances, where (1) an owner exercises complete domination of the corporation in respect to the transaction attacked; and (2) such domination was used to commit a fraud or wrong against the plaintiff which resulted in the plaintiff's injury, the burden shifts to the defendant to prove the fairness of the challenged acts (*Kantor v. Mesibov*, 8 Misc.3d 722, 796 N.Y.S.2d 884, (Sup. Court, Nassau Co. 2005), *Morris v. New York State Dept. of Taxation and Finance*, 82 N.Y.2d 135 (1993). Laifer does not prove the fairness of his acts of compensating himself and providing excessive compensation to Heartwatch's consultants who failed to produce any benefit to the company and shareholders.

Here again, Laifer cites cases that are distinguishable from the present litigation: In *Zuckerbrod v. 355 Co., LLC*, 113 A.D. 3d 675, 2014 WL 128565 (2nd Dept., 2014), defendant acted in good faith when he retained revenue derived from buildings owned by the LLC to pay for repairs and improvements on those buildings, and also when he entered into a management agreement on behalf of the LLC. Here, Laifer did not have the authority to violate the Operating Agreement without the express written consent of the other Heartwatch members.

In *Carroll v. Radoniqi*, 105 A.D.3d 493, 959 N.Y.S.2d 503 (1st Dept., 2013), a condominium Board acted in good faith in determining that its employee's renovation work did not create a nuisance to plaintiff's abutting unit. Here, Laifer failed to act in good faith by taking actions that that were strictly prohibited in the Operating Agreement and Letter Agreement. In *North Fork Preserve Inc. v. Kaplan*, 68 A.D.3d 732, 733, 890 N.Y.S.2d 93 (2nd Dept., 2009) the court granted defendant's motion for summary judgment because plaintiffs failed to produce any evidence to substantiate their allegations for fraud, bad faith, the waste of corporate assets, or the breach of fiduciary duty. Here, the evidence is overwhelming that Laifer breached the terms of the Operating Agreement and Letter Agreement, that Laifer induced MC to provide additional investments to Heartwatch based on his promise to abide by the Operating Agreement then in place, and that no Waivers or Amendments were ever duly executed by Heartwatch's members.

In *Hui v. Ho*, 1 A.D.3d 274, 767 N.Y.S.2d 582 (1st Dept., 2003), the court dismissed the complaint because defendant's challenged conduct of issuing shares of stock to parties other than plaintiffs did not violate the Shareholders' Agreement. Here, Laifer acted in direct violation of the Operating Agreement and Letter Agreement. In *Bennett v. Instrument Systems Corp.*, 66 A.D.2d 708, 411 N.Y.S.2d 287 (1st Dept., 1978), the court dismissed for failure by plaintiff to come forward with any affidavit to substantiate charges of waste, fraud and breach of fiduciary duty alleged in the complaint. Here, Richard Jedwab's affidavit and exhibits substantiates MC's charges against Laifer.

In *Sandfield v. Goldstein*, 33 A.D.2d 376, 308 N.Y.S.2d 25 (3rd Dept., 1970), plaintiff, a minority stockholder in a closely held corporation, could not establish fraud involving payments of company assets that were authorized by a resolution of the board of directors. Here, Heartwatch's members never duly executed any Amendments that would allow Laifer to receive compensation as Manager. In *Wellington Bull & Co. v. Morris*, 132 Misc. 509, 230 N.Y.S. 122 (Sup. Ct. N.Y. Co. 1928), the court held that subject to interference by the courts in cases of clear abuse, the directors of a corporation have the right to fix the compensation of the executive officers. Here, Heartwatch's members fixed the compensation of its Manager by expressly prohibiting any compensation.

Laifer cannot claim that his actions are protected by the business judgment rule because his self-dealing, fraud and bad faith fall under the exception to the business judgment rule. "The business judgment rule does not protect corporate officers or partners who engage in fraud or self-dealing, or corporate fiduciaries when they make decisions affected by an inherent conflict of interest. *Wolf v. Rand*, 258 A.D.2d 401, 404, 685 N.Y.S.2d 708 (1st Dept.1999); *Simpson v. Berkley Owner's Corp*., 213 A.D.2d 207, 623 N.Y.S.2d 583 (1st Dept. 1995); *Auerbach v. Bennett*, 47 N.Y.2d 619 (1979); *LoRusso v. Brookside Homeowner's Ass'n, Inc*., 17 A.D.3d 323, 793 N.Y.S. 2d 96 (2nd Dept., 2005). In *Limmer v. Medallion Group*, 75 A.D.2d 299, 428 N.Y.S.2d 961 (1st Dept., 1980), the court held that "[D]irectors and officers are bound by their duty of undivided and unqualified loyalty to their corporations, a duty which encompasses good faith efforts to insure that their personal profit is not at the expense of their corporations. (Business Corporation Law, § 717; see 19 CJS, Corporations, § 761, and cases cited.) In such instances of self-dealing, defendants have the burden of demonstrating the fairness of the transactions."). In *Matter of Morris v. New York State Dept. of Taxation and Fin*., 82 N.Y.2d 135, 141-2, 623 N.E.2d 1157, 603 N.Y.S.2d 807 (1993), the court held that piercing the corporate veil requires a showing that (1) the owners exercised complete domination of the corporation in respect to the transaction attacked; and (2) such domination was used to commit a fraud or wrong against the [Plaintiff] which resulted in [that Plaintiff's] injury.). Under such circumstances, the burden shifts to the Defendant to prove the fairness of the challenged acts.

Here, Laifer paid himself almost $500,000, despite being prohibited from receiving any compensation as Heartwatch Manager. Confronted with MC's discovery of his defalcation, Laifer has concocted an after the fact excuse that he supposedly received these payments from Heartwatch in another capacity -- his role as "medical director, medical advisor, medical guru, whatever you want to call it." (See FL 81:2-4). It is disingenuous to believe that defendant simultaneously held two positions with Heartwatch, the first being the "unpaid" position of sole Manager of the entire company with the authority to make important financial decisions for Heartwatch, and the second amply compensated position of medical director/advisor/guru. None of any of the agreements or any other documents makes this distinction. In which case there can be no dispute that his actions involved self-dealing by illegally compensating himself almost $500,000 in violation of the Operating Agreement and Letter Agreement. Clearly, the business judgment rule should not apply.

In addition, Laifer authorized compensation to Heartwatch consultants totaling $330,563 between 2006 and 2008 (excluding payments to himself). Yet despite authorizing such vast sums of money to pay for a workforce dedicated to marketing and sales, not a single client or dollar of revenue was ever raised. In addition, Laifer authorized $94,000 in payments to Aerotel for the purchase of approximately 1000 fully operational heart monitoring that were never sold and yet cannot be located, having apparently disappeared into thin air. (See FL 96:20-97:7).

Given Laifer's self-dealing, highly suspect authorizations of excessive expenditures for consultants who provided no apparent value to the company, and in light of the valuable missing equipment, the Court cannot apply the business judgment rule in deferring to Laifer's decision as Manager of Heartwatch.

In addition, the courts in New York have long established that directors cannot abuse their positions to vote for salaries for themselves at the expense of the corporation or the minority shareholders. In *Jacobson v. Brooklyn Lumber Co*., 22 Bedell 152 (Court of Appeals,1906), the court held that the relation of an officer of a corporation to it is fiduciary, and he must at all times act in good faith and unselfishly towards the corporation. The relation is such that an officer of a corporation cannot make an agreement with himself acting on the one part individually and for his own benefit, and on the other part in his fiduciary capacity as an officer of the corporation. In *Carr v. Kimball*, 153 A.D. 825, 139 N.Y.S. 253 (1st Dept., 1912) the court held where majority stockholders elected themselves directors, then officers, and then distributed a substantial part of the profits to themselves by voting themselves excessive salaries, the minority by a representative action could compel a return of the fund to the corporation's treasury. In *Coleman v. Second Ave. R. R. Co.*, 38 N. Y. 201 (1868), the directors, acting as directors and composing a majority of the board, could not make a bargain with themselves binding upon the company. In *Sage v. Culver*, 147 N.Y. 241 (1895) the court noted that where it appears that the trustee or other officer has violated the moral obligation to refrain from placing himself in relations which ordinarily produce a conflict between self-interest and integrity, there is in equity a presumption against the transaction, which he is required to explain. In *Bosworth v. Allen*, 168 N.Y. 157, 61 N.E. 163 (1901), the court noted that directors of a corporation are charged with duties of trustees, and bound to care for its property and manage its affairs in good faith, and for a violation of that duty, resulting in a waste of its assets, injury to its property, or unlawful gain to themselves, they are liable to account in equity the same as ordinary trustees. In *Davids v. Davids*, 135 App. Div. 206, 120 N. Y. Supp. 350 (1st Dept. 1909), the court held that directors have a duty to manage the business and affairs of the corporation with honesty and fidelity, having in view, not only their own interests, but the interests of the plaintiff. Simply because they happened to hold a majority of the stock, which enabled them to elect themselves directors, and that they constituted all the directors, gave them no right to vote themselves salaries. Salaries cannot be voted under such circumstances, and, when so voted and paid, the money can be recovered back for the corporation at the suit of an aggrieved stockholder.

Here, Laifer was the only Managing Member of Heartwatch and authorized compensation to himself in excess of $498,000 without the approval of any of the company's other shareholders and in direct contravention of the Operating Agreement prohibiting compensation to Heartwatch's Manager. His illegal authorization to compensate himself should not entitle him to keep any of his ill-gotten funds.

POINT THREE

DEFENDANT WAS IN BREACH, AND PLAINTIFF NEVER WAIVED ANY CLAIM OF BREACH

Laifer clearly breached the provision of the Operating Agreement which prohibited him from receiving any compensation. Indeed, it is undisputed that Laifer paid himself the sum of $498,640, from 2006 through 2008, which is clearly prohibited by the Operating Agreement. To avoid the consequences of his unlawful conduct, Laifer argues that MC has apparently waived its right to assert this breach on behalf of Heartwatch in its derivative claim. A finding of waiver of an important contractual right should not be lightly made. Rather, a waiver of contractual right must be based on a clear manifestation of intent to relinquish a contractual provision. *Fundamental Portfolio Advisors, Inc. v. Tocqueville Asset. Mgmt*., LP, 7 N.Y.3d 96, 817 N.Y.S.2d 606 (2006); *Natale v. Erns*t, 63 A.D.3d 1406, 881 N.Y.S.2d 232 (3rd Dept., 2009).

Given the explicit non-waiver provision in the Operating Agreement, in the absence of clear evidence evidencing such a waiver, that defense should not be applied.

Again, Laifer relies on cases that are factually distinguished from the present litigation. Thus, in *Brooklyn Pub. Library v. City of New York*, 250 N.Y. 495 (1929), the court looked to the language of the agreement to determine liability. Here, the language of the Operating Agreement leaves no room for inference concerning waivers and requires a duly executed writing signed by all the members specifically referring to each right or remedy being waived. In *William C. Atwater & Co. v. Panama R. Co.*, 255 N.Y. 496 (1931), the court looked to an agreement that cited circumstances in which the requirements for delivery and acceptance could be waived. Here, no such wriggle room was written into the Operating Agreement, which strictly prohibits waivers unless duly executed in writing, signed by all members and specifically referencing the rights or remedies to be waived.

In *Madison Ave. Leasehold, LLC v. Madison Bentley Associates LLC* 30 A.D. 3d 1, 811 N.Y.S.2d 47 (1st Dept., 2006) a landlord's practice of accepting the proffered rent payments, without protest, over a period of three years, constituted a course of conduct effecting a waiver of the timely payment covenant, but only because the tenant complied with the terms of lease agreement in making rent payments each month within the 20-day grace period. Here again, the Operating Agreement's strict requirements of waiver are not met. Moreover, Laifer failed to comply altogether with the terms of the Operating Agreement and Letter Agreement by illegally compensating himself and authorizing excessive expenditures on consultants.

In *Accord In Re Field's Will*, 11 A.D.2d 774, 204 N.Y.S.2d 97 (2d Dept. 1960) decedent pledged a charitable contribution to petitioner on the condition that petitioner raise a specified amount of funding from a separate source. When petitioner raised said sum in the form of a pledge, the executors of decedent's estate asserted that pledges were not entitled to consideration unless they were legally enforceable. The Court found that the decedent considered the pledge in dispute to be collectible, based on resolutions passed by the petitioner's finance committee on which the decedent served. Here, Laifer was actually a signatory to the Operating Agreement and Letter Agreement that prohibited compensation for Heartwatch's Manager and excessive spending, and imposed strict requirements for waivers.

Laifer acted in breach of the Letter Agreement and Operating Agreement by illegally compensating himself and authorizing excessive compensation to Heartwatch consultants. MC simply asks the Court to uphold the terms of the Agreements "as they were when they were entered into" (*Brooklyn Life Ins., supra*). To reiterate, Article VII, paragraph 2 of the Operating Agreement is clear and unambiguous with respect to waivers. It states that: "No failure of a member to exercise and no delay by a member in exercising any right or remedy under this Operating Agreement shall constitute a waiver of such right or remedy. No waiver by a member of any such right or remedy under the Operating Agreement shall be effective unless made in writing duly executed by all members and specifically referring to each such right or remedy being waived."

In the absence of any duly executed waivers, MC retains all of its rights and remedies under the waiver clause. No waivers were ever duly executed by MC or any other Heartwatch members. Therefore, MC has not waived any claim of breach against Laifer. Accordingly, there is no issue of fact as to Laifer's breaches of the agreements.

POINT FOUR

DEFENDANT IS IN BREACH OF CONTRACT

The facts of this case firmly establish that Laifer is in breach of contract. The following elements must be established on a breach of contract claim: (1) a valid and enforceable contract; (2) the plaintiff's performance of the contract; (3) breach by the defendant; and (4) damages. See *Noise in Attic Prods., Inc. v London Records*, 10 AD3d 303, 307 (1st Dep't 2004); *Furia v Furia*, 116 AD2d 694, 695, 498 N.Y.S.2d 12 (2d Dep't 1986). Here there is no issue as to the satisfaction of each of these elements. Indeed, given the derivative nature of this claim, HW was substantially damaged by Laifer's breach.

Moreover, New York law is well settled concerning the four corners rule. In *W.W.W. Associates, Inc., v. Giancontieri*, 77 N.Y.2d 157, 565 N.Y.S.2d 440, 566 N.E.2d 639 (1990), the court held that when parties set down their agreement in a clear, complete document, their writing should as a rule be enforced according to its terms. Evidence outside the four corners of the document as to what was really intended but unstated or misstated is generally inadmissible to add to or vary the). In *Abraham J. Rodolitz, v. Neptune Paper Products,Inc., et al*. 22 N.Y.2d 383, 292 N.Y.S.2d 878, 239 N.E.2d 628 (1968), the court held it may not, under the guise of interpretation, make a new contract for the parties or change the words of a written contract so as to make it express the real intention of the parties if to do so would contradict the clearly expressed language of the contract). In *Raleigh Assoc.* v. *Henry*, 302 N. Y. 467, 473, 99 N.E.2d 289 (1951), the court noted that "we concern ourselves with what the parties intended, but only to the extent that they evidenced what they intended by what they wrote." In *West, Weir & Bartel, Inc., v. Mary Carter Paint Company*, 25 N.Y.2d 535, 307 N.Y.S.2d 449, 255 N.E.2d 709 (1969) the court held that the construction of a plain and unambiguous contract is for the court to pass on, and that circumstances extrinsic to the agreement will not be considered when the intention of the parties can be gathered from the instrument itself".

Here, Laifer entered into valid and enforceable contract that contained clear and unambiguous terms. The Operating Agreement stated that the Manager shall not be entitled to any compensation. It also stated that no Amendment shall be effective unless made in writing duly executed by all members and specifically referring to the provision being amended. It further stated that no waiver shall be effective unless made in writing duly executed by all members and specifically referring to each such right or remedy being waived. Likewise, the Letter Agreement was clear: Heartwatch could not spend more than $50,000 in the first two months following MC's initial investment, and could not spend more than $37,500 in the four months thereafter. Moreover, MC's investment could only be used for legal working capital purposes.

After entering into a valid and unambiguous contract that prohibited Heartwatch's Manager from receiving compensation, Laifer authorized almost $500,000 in compensation for himself as Manager. No Amendments to the Operating Agreement were ever duly executed by Heartwatch's members, and no rights or remedies were ever waived by them. Thus, Laifer was in breach of the Operating Agreement. He was also in breach of the Letter Agreement by using $113,500 of MC's initial investment to compensate himself, which did not qualify as legal working capital purposes.

POINT SIX

THE COURT SHOULD SEARCH THE RECORD AND GRANT SUMMARY JUDGMENT TO PLAINTIFF PURSUANT TO CPLR 3212(B)

By this Court's order dated July 24, 2014, it extended the parties' time to move for summary judgment to August 21, 2014. While the allotted time may have expired for MC to file a cross-motion for summary judgment, this Court is well within its right to grant summary judgment to MC in accordance with CPLR 3212(b) without the necessity of a cross-motion. As the Court of Appeals noted in *Merritt Hill Vineyards v. Windy Hgts. Vineyard*, 61 N.Y.2d 106, 472 N.Y.S.2d 592, 460 N.E.2d 1077(1984), "CPLR 3212 (subd [b]) provides that 'if it shall appear that any party other than the moving party is entitled to a summary judgment, the court may grant such judgment without the necessity of a cross-motion." See also *Dunham v Hilco Constr. Co*., 89 N.Y.2d 425, 654 N.Y.S.2d 335, 676 N.E.2d 1178 (1996). There is no issue of fact that Laifer breached the Operating Agreement when he paid himself compensation totaling almost $500,000.00 and breached the Letter Agreement by using MC's funds for the illegal purpose of compensating himself.

POINT SEVEN

PUNITIVE DAMANGES AND ATTORNEYS FEES ARE WARRANTED

The Court should award punitive damages and attorneys' fees to MC based on Laifer's fraudulent conduct and the public-interest nature of the services Heartwatch set out to provide.

The law in this state is clear that recovery of exemplary damages in an action for breach of contract is not authorized where only a private wrong and not a public right is involved or in the "ordinary" fraud case. To recover punitive damages in an action for fraud, it must appear that the fraud was upon the general public, that is, "aimed at the public generally, is gross and involves a high degree of moral culpability." (see *Walker v. Sheldon*, 10 N.Y.2d 401, 405, 223 N.Y.S.2d 488, 179 N.E.2d 497 (1961); *Garrity v. Lyle Stuart, Inc*., 40 N.Y.2d 354, 386 N.Y.S.2d 831, 353 N.E.2d 793 (1976); *Catalogue Service of Westchester, Inc., v. Insurance Co. of North America*, 74 A.D.2d 837, 425 N.Y.S.2d 635 (2nd Dept., 1980) (punitive damages are awardable, not for an isolated transaction incident to an otherwise legitimate business, but for a gross and wanton fraud upon the public.); *Gale v. Kessler,* 93 A.D.2d 744, 461 N.Y.S.2d 295 (1st Dept., 1983); *Catalogue Service of Westchester, Inc., v. Insurance Co. of North America*, 74 A.D.2d 837, 425 N.Y.S.2d 635 (2nd Dept., 1980) (punitive damages are awardable, not for an isolated transaction incident to an otherwise legitimate business, but for a gross and wanton fraud upon the public).

Here, Laifer not only fraudulently induced MC to invest in Heartwatch, he did so with the promise of literally saving lives. The aim of Heartwatch was to provide early heart attack detection capabilities. Heartwatch's literature identifies heart attacks as the single biggest killer in the U.S., and touts Heartwatch's heart attack detection service as being capable of dramatically improving a patient's chances of survival. As such, this is no ordinary fraud case considering the public health benefits that a company like Heartwatch could have provided if it were managed by someone who did not breach his fiduciary duties. Furthermore, there is a strong public interest in protecting investors like MC from being defrauded, and in sending a message of warning to those who might engage in fraud against such investors. MC was willing to risk its capital on a double-bottom line investment strategy that aimed not only to generate profit but also to promote the public good. But instead of building a company that tackled the biggest killer in the U.S., MC's investments went straight into the pocket of a doctor who abused his trust as a healer in order to line his pockets with his investors' money. Lives could have been saved if Laifer hadn't acted in breach. It therefore behooves the Court to make an example of Laifer by granting punitive damages and attorneys' fees to MC, both because of the nature of the fraud and as a warning to others not to engage in misconduct that could have life and death consequences for a significant portion of the population.

Conclusion

Laifer's self-dealing, breach of contract and fraudulent actions cannot be excused by this Court. At the very least, sufficient triable issues of fact exist such that this Court must deny Laifer's motion for summary judgment on all counts. In any case, Laifer's conduct in breaching his agreements with Heartwatch and MC, warrant this Court's application of CPLR 3212(b) and granting a summary judgment in favor of plaintiff.

Date: New Rochelle, New York
October 21, 2014

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By:______________________

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