NORTH CAROLINA

GUILFORD COUNTY

IN THE GENERAL COURT OF JUSTICE
SUPERIOR COURT DIVISION
06 CVS 10500

LEONARD J. KAPLAN,

Plaintiff,

v.

O.K. TECHNOLOGIES, LLC, LAURENT OLIVIER, DAVID F. MESCHAN, JEFFREY BOWMAN, and AQUATIC EVOLUTION INTERNATIONAL, INC.,

Defendants.

BRIEF IN SUPPORT OF MOTION OF PLAINTIFF LEONARD J. KAPLAN FOR SUMMARY JUDGMENT

Pursuant to Rule 15 of the General Rules of Practice and Procedure for the North Carolina Business Court, plaintiff Leonard J. Kaplan ("Kaplan") submits this Brief in Support of his Motion for Summary Judgment.

STATEMENT OF PROCEDURAL HISTORY

On September 21, 2006, Kaplan filed a Complaint against O.K. Technologies, LLC ("O.K."), Laurent Olivier ("Olivier"), Jeffrey Bowman ("Bowman"), Aquatic Evolution International, Inc. ("AEI") and David Meschan ("Meschan"). Kaplan seeks to recover loans made to O.K. that have not been repaid by the company. Kaplan also seeks damages from Olivier caused by Olivier's breaches of fiduciary duty.

Contemporaneous with the Complaint, Kaplan filed a Motion for Temporary Restraining Order and Preliminary Injunction, and further requested that the court appoint a Receiver to secure and sell the assets of O.K. consistent with N.C.G.S. § 57C-6-02.2.

On October 4, 2006, the Court entered a Consent Order Appointing Receiver and Preliminary Injunction. The order appointed William P. Miller as the Receiver and directed him to wind up the affairs of O.K. The Order also enjoined the members of O.K. from distributing, disbursing, converting or otherwise transferring the assets of O.K.

On January 31, 2007, the Court entered an Order approving the Receiver's Application For, Among Other Things, Court Confirmation of Sale of All of the Company's Assets and Request for Expedited Hearing to Approve Sale Procedure. In the Order, the Court approved a sale procedure whereby the purchaser of O.K.'s assets would provide at closing an irrevocable letter of credit for the gross purchase price of $2,000,000, less the Receiver's fees, the cost of the letter of credit and any court-approved costs of administration advanced by Kaplan on behalf of O.K. The Receiver and the parties have referred to this reduced purchase price as the "Net Purchase Price."

On March 12, 2007, the Court entered an Order confirming the sale of the assets of O.K. to Kaplan's designee. On March 13, 2007, the Receiver entered into an Asset Purchase Agreement with Kaplan's designee, Scientific Associates, LLC. Kaplan provided the requisite letter of credit to the Receiver and the Receiver transferred all of O.K.'s assets to Scientific Associates, LLC. Consistent with prior orders of the Court, the gross purchase price and letter of credit was reduced by the following sums: (i) the Receiver's fees and costs in the amount of $74,056.94; (ii) the fee of IP Mercantile in the amount of $15,000; and (iii) the actual cost of the letter of credit in the sum of $19,000. As such, the Net Purchase Price was $1,891,943.10.[1]

[1] On December 10, 2007, the Receiver filed an Application seeking additional fees totaling $26,001. On December 11, 2007, Kaplan filed an Application for Approval for Costs of Administration, totaling $74,433. If the Court approves these fees and costs, the Net Purchase Price would be reduced to $1,791,509.

STATEMENT OF PERTINENT FACTS

A. Formation of O.K. Technologies

Prior to 2003, Bowman serviced an aquarium in Kaplan's Florida home. Bowman informed Kaplan about Olivier's ideas relating to improving the water quality in aquariums. Thereafter, Kaplan discussed a business relationship with Bowman and Olivier and invited them to Greensboro to present Olivier's ideas. (Bowman pp. 30-37).[2]

On or about September 3, 2003, the parties executed the Operating Agreement of O.K. Each of the members also signed an Independent Contractor Agreement. The Operating Agreement and other formation documents were prepared by attorneys with Tuggle Duggins. (Hardin pp. 10-11, 27).

B. The Material Terms of the Operating Agreement

O.K. was a member-managed LLC. Decisions were made by a vote of the Majority in Interest, defined as those members whose interests in the company constituted a majority. (Op. Agrmt. p. 10 & Ex. C).[3] The initial membership interests were Kaplan, 51%; Olivier, 43%; and Bowman, 6%. The Operating Agreement provided that Meschan would become a member upon the occurrence of certain conditions, which would alter the membership interests to Kaplan, 41.5%; Olivier, 37.5%; Meschan, 15%, and Bowman, 6%. (Op. Agrmt. p. 5). Meschan was admitted as a member in July 2004.

The Operating Agreement required Kaplan to contribute $200,000 in capital. Olivier's and Bowman's contribution was the assignment of "Technologies" and other assets owned by them. (Op. Agrmt. pp. 3-4).[4] Olivier, Bowman and AEI documented their assignment in a Bill of Sale, also prepared by Tuggle Duggins, dated September 3,

[2] Citation to depositions include the name of the deponent and page number(s) of the transcript.
[3] Each exhibit referenced in this Brief is included in the attached Appendix.
[4] "Technologies" is specifically defined by section 2.1(b) of the Operating Agreement.

2003. (Olivier Ex. 4). Meschan was not obligated to contribute any capital, although he was required to provide legal and patent-related services for O.K. at no charge. (Op. Agrmt. p. 5 & Ex. G-4).

The Operating Agreement limited the duties, and thus the liability, that one member owed to another. Section 5.3 provided:

> Section 5.3 Limitation on Liability. Notwithstanding any other provision to the contrary contained in this Agreement, no Member shall be liable, responsible, or accountable in damages or otherwise to the LLC or to any other Member or assignee of a Member for any loss, damage, cost, liability or expense incurred by reason of or caused by any act or omission performed or omitted by such Member, whether alleged to be based upon or arising from errors in judgment, negligence, gross negligence, or breach of duty (including alleged breach of any duty of care or duty of loyalty or other fiduciary duty) except for (i) acts or omissions the Member knew at the time of the acts or omissions were clearly in conflict with the interest of the LLC, (ii) any transaction from which the member derived an improper personal benefit, or (iii) a willful breach of this Agreement. Without limiting the foregoing, no Member shall in any event be liable for (A) the failure to take any action not specifically required to be taken by the Member under the terms of this Agreement, (B) any action or omission taken or suffered by any other Member, or (C) any mistake, misconduct, negligence, dishonesty or bad faith on the part of any employee or other agent of the LLC appointed by such Member in good faith.

(Op. Agrmt. p. 10).

C. Kaplan's Loans to O.K.

Kaplan completed his capital contribution to O.K. in May 2004. (Kaplan Aff. Ex. A). Thereafter, Kaplan made numerous loans to O.K. to enable it to discharge costs, expenses, obligations and liabilities. (Kaplan Aff. Ex. B). O.K. and its members accepted the loans and used them to discharge the Company's costs, expenses, obligations and liabilities. As of July 31, 2006, the principal balance of the loans (without interest) was $1,864,749. (Kaplan Aff. ¶ 4 & Ex. B). The company has failed to satisfy the debt owed to Kaplan.

D. Dissolution of O.K.

On July 31, 2006, each of the four members of O.K. voted to dissolve and wind up the affairs of the company. (Kaplan Aff. ¶ 2). During that meeting, the members failed to agree on a mechanism for repaying the loans made by Kaplan. Meschan further moved to designate Olivier and himself as O.K.'s representatives for the purpose of (a) initiating future contact with any potential buyers or licensees and (b) negotiating any sale of assets or licensing of any technologies owned by or assigned to the company. Meschan, Olivier and Bowman voted in favor of the motion and Kaplan voted against the motion. (Kaplan Aff. ¶ 3).

On August 8, 2006, Olivier and Bowman sent Kaplan and Meschan an e-mail, which indicated that they were "moving on" and would be hard to locate. (Olivier Ex. 14). Olivier and Bowman also disclosed that they had removed assets belonging to O.K. Id. In a subsequent e-mail dated August 15, 2006, Oliver further abandoned the responsibilities he assumed as one of two representatives of O.K. to initiate efforts to sell the Company's assets. (Olivier Ex. 17). In a September 8, 2006 email, Bowman reiterated that Olivier would be unavailable to O.K. (Bowman Ex. 16).

LEGAL STANDARD

Summary judgment shall be rendered if the pleadings, depositions, answers to interrogatories, and admissions on file, together with the affidavits, if any, show that there is no genuine issue as to any material fact and that any party is entitled to judgment as a matter of law. N.C. R. Civ. P. 56(e). A genuine issue is one that can be maintained by substantial evidence; a material fact is that which would constitute a legal defense

preventing the non-moving party from prevailing. Bd. of Ed. of Hickory Admin. School Unit v. Seagle, 120 N.C. App. 566, 463 S.E.2d 277 (1995).

A movant satisfies his burden of showing that he is entitled to judgment as a matter of law by showing either (1) an essential element of the non-movant's claim is nonexistent, (2) the non-movant cannot produce evidence to support an essential element of his claim, or (3) the non-movant cannot surmount an affirmative defense which would bar his claim. Taylor v. Ashburn, 112 N.C. App. 604, 606-607, 436 S.E.2d 276, 278 (1993), cert. denied, 336 N.C. 77, 445 S.E.2d 46 (1994). The burden then shifts to the non-movant, who cannot rest upon mere allegations or denials in pleadings but instead is required to offer evidence tending to establish, beyond mere speculation or conjecture, the essential elements of its claims. N.C. R. Civ. P. 56(e).

ARGUMENT

I. O.K. TECHNOLOGIES HAS FAILED TO REPAY LOANS THAT KAPLAN ADVANCED TO THE COMPANY.

As of July 31, 2006, the date the members unanimously agreed to dissolve O.K., Kaplan had advanced $2,064,748 to O.K. (Kaplan Aff. ¶ 4). The first $200,000 of this amount was capital. The principal balance of $1,864,748 constituted loans to O.K., which the company has failed to pay. (Kaplan Aff. Exs. A & B).

The only asset of O.K.—the letter of credit—totals $1,891,943. The Receiver and Kaplan have filed Applications requesting that the letter of credit be reduced further by the Receiver's fees and the costs of administration. If the Applications are approved, the principal balance of outstanding loans would exceed O.K.'s only asset.[5] As such, the entire amount secured by the letter of credit should be released to Kaplan.

[5] See footnote 1, *supra*.

A. Kaplan's Excess Contributions to O.K. were Debt, Not Equity.

The O.K. Operating Agreement obligated Kaplan to contribute $200,000 in capital in one or more installments as needed for the operations of the company. (Op. Agreement, p. 3). The Operating Agreement further obligated Kaplan to guarantee up to $500,000 in loans to the company. No party disputes the fact that Kaplan satisfied the $200,000 capital contribution and made $500,000 in loans. (Meschan Vol. II, p. 184; Olivier p. 226).[6]

It is also undisputed that Kaplan contributed $1,364,748 to the company in excess of the initial $700,000 obligation. (Kaplan Aff. Exs. A & B; see also Kaplan Vol. II, Ex. 15). While some of the defendants would now like to characterize the excess contributions as equity rather than debt, the evidentiary record establishes that they were loans.

1. The Parties Expressed a Preference for Debt Over Additional Capital.

Section 2.3 of the Operating Agreement states: "It is the preference of the members to fund any additional capital needs of the LLC with corporate borrowings." (Op. Agrmt., p. 5). Thus, the members expressed a preference for debt over equity. Section 2.3 also limits the capital that may be required: "[A]dditional capital contributions may be approved by the members at any time . . . provided, however, that the total additional contributions required from the members shall not exceed fifty percent (50%) of the cumulative distributions previously made by the LLC to the

[6] Meschan testified that the $500,000 had to be a bank loan secured by Kaplan's personal guarantee. (Meschan Vol. II, p. 184). His colleague, Eric Hardin, who drafted the documents, disagreed. (Hardin pp. 21-22). Whether the loan was made by Kaplan or guaranteed by him is an immaterial distinction in any event. Had Kaplan personally guaranteed a bank loan, a personal guaranty would have been called by the bank after O.K. became unable to pay, placing Kaplan in the same creditor status as he is today.

Members." As O.K. never made a distribution, no capital could be required of the members. These terms are clear indicia that Kaplan's contributions were debt, not equity.

2. Kaplan made Loans Consistent with the Operating Agreement.

The Operating Agreement permitted members of O.K. to loan funds to the company:

> Loans to LLC. Any Member may, but shall not be obligated to, advance needed funds to the LLC to enable it to discharge costs, expenses, obligations, liabilities, and charges incurred incident to the operating of its business if such advance is first approved by the Members in accordance with the provisions hereof. Nothing in this Agreement shall prevent any Member from making secured or unsecured loans to the LLC by agreement the LLC. Unless otherwise agreed, any loans to the LLC by a Member shall be repayable ten (10) days after demand thereof, shall be unsecured and shall bear interest at the Interest Rate. Repayment of any outstanding loan from any Member to the LLC shall have first priority over the payment of any distributions to the Members under Article III except with the written consent of the Member making such loan.

(Op. Agrmt. p. 6). Kaplan recognizes that the members of O.K. did not approve in writing each loan in excess of the initial $700,000 required of him. Nonetheless, members knew that Kaplan was loaning the company money, and no one objected to his doing so. (Olivier pp. 226-27). Under these circumstances, the members of O.K. ratified the loans and the company should be held to the repayment obligation as set forth in section 2.4.

Loans made consistent with section 2.4 are payable ten days after demand and bear interest at the Interest Rate.[7] Assuming interest at the Interest Rate, O.K. was indebted to Kaplan in the amount of $2,014,438 as of July 31, 2006. (Kaplan Aff. Ex. B).

[7] "Interest Rate" is defined by the Operating Agreement as "The prime rate of Wachovia Bank of Greensboro, North Carolina or its successor, as announced by it from time to time." (Op. Agrmt. Ex. C).

3. Kaplan is O.K.'s Only Creditor.

Whether the loans were made under the Operating Agreement or not, O.K.'s assets must first be applied to Kaplan, who is the company's only creditor. N.C.G.S. § 57C-6-05 (2005) ("Upon the winding up of a limited liability company, its assets shall be applied . . . [first] to creditors, including members who are creditors."). This result is also consistent with section 10.4 of the Operating Agreement, which provides that proceeds from the disposition of O.K.'s noncash assets are to be distributed first to the LLC's creditors. (Op. Agrmt. pp. 20-21).

The other members have acknowledged Kaplan's loans are debts of the company. Meschan testified the contributions were loans:

> Let me clarify one thing from yesterday that occurred to me last night in response to things—things that Eric Hardin got into his testimony. My position on advances by [Kaplan] or money passing from [Kaplan] to [O.K.], other than the 200, was that they were loans.

(Meschan Vol. II p. 9). He later clarified this point further:

> I think what I said was that my position was that a – it was a debt that was owed to [Kaplan] for any money he advanced above the $200,000 capital contribution he made, but that that loan was an undocumented loan and that, after looking at it last night, I felt that the agreement was very explicit on that; that the agreement at least provided that the loans, the 500,000 above the 200, had to be in the form of guaranteed bank loans, which they were not. But I – I – I made it clear, I think, this morning that I didn't – that my position is that it's debt owed to Leonard Kaplan subject to whatever defenses might arise in favor of the LLC.

(Meschan Vol. II p. 184). Similarly, Eric Hardin testified:

> Q: Do you know what the nature of the contributions in excess of $700,000 were intended to be in terms of debt, equity? How was that characterized?
>
> A: I don't think that we were thinking about it at the time he made the contributions. I think if you look back at the operating agreement and what was – what we had in mind then, we were

> contemplating that he would either guarantee money or loan monies to the LLC and that any additional monies he put in would be loans. I don't know that that was ever formally discussed but I know it was—If you had asked me at the time, I would have said that they were loans. I can tell you there's a provision in the operating agreement that allocates Leonard all of the tax losses of the LLC as long as he had loans outstanding, and I remember thinking that that provision was operative in 2004 and 2005.

(Hardin p. 43).

Olivier and Bowman also understood that Kaplan's advances were loans and not capital contributions. For example, on January 26, 2006, their attorney sent a letter to Kaplan demanding, among other things, that the ten-day call option be amended:

> 6. My clients suggest a hold on recapitalization of the corporation. There appears to be no need for recapitalization at this time when over $600,000.00 of *the original loan* remains in place. . . .
>
> 9. Currently, Mr. Kaplan has the ability pursuant to the operating agreement to demand repayment on *his loan* within ten (10) days. Obviously this is untenable considering the financial status of the corporation. The operating agreement must be amended accordingly.

(Olivier Ex. 8) (emphasis added). Olivier and Bowman approved this letter and authorized their attorney to send it on their behalf. (Olivier p. 151; Bowman pp. 155-56).

Hardin also testified about a June 2005 meeting with Meschan and Olivier, during which Olivier expressed concern about the company's ability to repay the loans. (Hardin. pp. 71-74 & Ex. 9). Olivier's concern led to further discussions about amending the ten-day call provision. (Hardin. pp. 71-74; Meschan Exs. 4 & 5; Olivier pp. 156-60). During these discussions, no member contended that the money advanced by Kaplan was capital instead of debt.

Similarly, after Kaplan called his loan in June 2006, Meschan wrote a letter to the other members of the company, urging them to take action to repay it:

> As you are aware, the LLC has recently received written demand *from its only substantial creditor* for payment of approximately $1.8 million. . . . Moreover, *the creditor* has recently contended in other communication that the LLC is insolvent. If that is the case, each of us owes a fiduciary duty to such *creditor* to use his best efforts to get him paid—to the fullest extent possible—from corporate assets. . . . As you know, the LLC has no liquid assets from which to pay debt. There are essentially three ways to gain liquidity: (1) seek a loan; (2) seek one or more new investors; or (3) sell off assets, in whole or in part, as may be necessary. With no revenue from which to make periodic payments, a loan is highly unlikely in any significant amount. Current disharmony among members would further make it extremely improbable that a new investor would want to come in. Therefore, I believe that sale of assets is the only feasible route to take.

(Meschan Ex. 19) (emphasis added). These examples illustrate the members' clear understanding that Kaplan was not infusing capital into O.K. but was loaning it operational funds. The members are estopped from asserting a different litigation position.

B. O.K. is Not Entitled to Any "Equitable Offset."

Defendants seek to avoid the consequences of Kaplan's creditor status by asserting various affirmative defenses and counterclaims. The specific claims asserted by defendants are addressed in Section III *infra*. Succinctly put, there is no basis for an "equitable offset" against Kaplan's debt, and O.K.'s only asset—funds secured by the letter of credit—should be released to Kaplan.

II. OLIVIER BREACHED FIDUCIARY DUTIES TO KAPLAN AND O.K.

Olivier breached fiduciary duties, as defined by Section 5.3 of the Operating Agreement, to Kaplan and O.K. His actions conflicted with the interests of O.K. and violated the requirements imposed on him by the Operating Agreement. Accordingly, Kaplan is entitled to damages from Olivier.

A. Olivier Acted in Clear Conflict with the Interests of the LLC.

The record is replete with examples of Olivier's actions that conflicted with the LLC's interests. They include:

- Olivier traveled to California to confer with Steve McCorkle, who owned a company with complimentary technology. During the visit, Olivier made negative comments about Kaplan, telling McCorkle that he was "pissed off" and believed O.K. had wasted money. (Olivier pp. 235-38; Massar pp. 52-53, 78-80). Olivier's comments foreclosed any opportunities to partner with McCorkle's company.

- Olivier frequently used O.K.'s truck, bobcat and other equipment for personal reasons. (Olivier p. 242; Massar p. 57).

- Olivier used the company's facility to grind kava for another venture owned by him and Bowman. (Olivier pp. 17-20).

- Olivier used the company's computer to view pornography and to participate in online gambling. (Olivier pp. 244-45).

- Olivier voted himself (along with Meschan) as the members charged with finding buyers for O.K.'s assets after dissolution, yet he failed to use best efforts to find potential buyers. (Olivier pp. 173-74). At the same time, he removed O.K.'s assets from the company's facility and indicated that he was moving and would be unavailable. (Olivier Exs. 14 & 17; Bowman Ex. 16).

- Olivier created a hostile working environment for other employees, and engaged in inappropriate behavior in their presence. (Massar pp. 47-51, 80-81 & Ex. 17).

B. Olivier Willfully Breached the Operating Agreement.

Pursuant to his Independent Contractor Agreement, Olivier was obligated to devote no less than forty hours each week to researching, developing and improving technology and applications of the technology. (Op. Agrmt. Ex. G-2). Beginning in April 2006, Olivier, by his own admission, ceased working on O.K.'s applications of the technology. (Olivier Exs. 11, 12).

For example, in April 2007, Olivier indicated to other employees that he would no longer work on the dairy waste project and that others would have to be responsible for it. (Massar pp. 50-51). Olivier also announced these intentions in several emails. (Olivier Exs. 11, 12). After withdrawing from the dairy waste efforts, Olivier isolated himself on a day-to-day basis. (Massar pp. 26-27).

Later, Olivier agreed to allow other employees to make decisions about the shrimp prototype, indicating that he was also finished working with the aquaculture system. (Massar p. 11). While employees were reporting their weekly activities, Olivier failed to account for his time or efforts. (Olivier Ex. 13; Massar Ex. 16). In failing to use his best efforts to advance the technology or its applications, Olivier breached fiduciary duties to Kaplan and O.K.

III. KAPLAN DID NOT BREACH FIDUCIARY DUTIES.

A. Kaplan and AEI Were Not Fiduciaries.

As an initial matter, Kaplan did not owe any fiduciary duty to AEI. AEI is a separate corporation owned by Olivier, Bowman and others. (Olivier pp. 12-14). AEI assigned assets to O.K., as provided by the Bill of Sale. (Olivier Ex. 4). AEI is not a member of O.K. and has no other interest in O.K. Under these circumstances, Kaplan and AEI were not fiduciaries, and Kaplan owed no duty to AEI.

B. Kaplan has not Breached Any Fiduciary Duties to O.K. or its Members.

As indicated *supra,* the duties that Kaplan and the other members of O.K. owed to each other and to the company are expressly defined by section 5.3 of the Operating Agreement. (Op. Agrmt. pp. 10-11).[8] None of defendants' allegations asserted against Kaplan violate section 5.3 of the Operating Agreement, which requires something more than negligence, errors in judgment or breaches of duty of care or loyalty. There is no evidence—indeed, no allegation—that Kaplan took actions or omissions "clearly in conflict with the interest of the LLC." Similarly, there is no evidence that Kaplan derived "an improper personal benefit" from any of his actions or that he willfully breached the Operating Agreement. Under these circumstances, all of defendants' claims and purported defenses fail.

1. Kaplan acted in the best interest of the LLC.

Defendants' lack any evidence that Kaplan acted in "clear conflict" with the interest of O.K. Indeed, when examined with the scrutiny required by section 5.3, defendants' claims amount to nothing more than complaints that they disagreed with some of Kaplan's recommendations and with the ultimate direction taken by the company.

Kaplan did not engage in "corporate waste." Other members now accuse Kaplan of engaging in "corporate waste," including payments to Aquastel (Olivier p. 211); for legal fees (Olivier p. 211-14); and for consulting fees (Olivier p. 215-16). Yet there is no evidence that any of these expenditures were for Kaplan's benefit or in "clear conflict" with O.K.'s interest. In fact, the evidence is to the contrary. Olivier and the other

[8] Section 5.3 of the Operating Agreement is consistent with N.C.G.S. § 57C-3-22, which allows contractual limitations on liability.

members had input and exercised it when making decisions about how to spend O.K.'s funds. (Olivier p. 211 & Exs. 7 & 10). At a meeting of the members on January 17, 2006, which Olivier decided not to attend, the other members discussed priorities and voted on how to expend funds. (Bowman pp. 94-101 & Exs. 4, 9). Even Olivier admits that he did not object to the funding process and that he continued to receive a paycheck up to O.K.'s dissolution. (Olivier p. 227).

Kaplan's opposition to manufacturing and selling "component products" was not in clear conflict with the interests of O.K. Bowman and Olivier also claim that Kaplan refused to allow them to manufacture and sell component products, and that O.K. would have generated revenue had they been allowed to do so. (Bowman p. 189-90). Yet they never brought this proposal to a vote of the membership, instead choosing to acquiesce to Kaplan's business judgment that selling component parts was not in the best interest of O.K. (Olivier pp. 230-31; Bowman pp. 189-90). Indeed, Bowman recalls that the members discussed selling components at the January 17, 2006 meeting, and they "decided to come back to [that] particular part of the budget and decide in the second quarter of that year whether or not we were going to work on that." (Bowman pp. 100-101 & Ex. 4). Moreover, because Meschan was also opposed to manufacturing component products, it would have been unlikely that the members would have voted to pursue a manufacturing operation had a vote been taken. (Meschan Vol. II pp. 93-95).

2. Kaplan did not derive any personal benefits.

There is no evidence that Kaplan derived a personal benefit from any action related to O.K. Indeed, the undisputed evidence is to the contrary.

Substantial sums of Kaplan's loans were paid to other members. Kaplan loaned the company over $1,800,000, which has not been repaid. On the other hand, AEI received payments from O.K. in excess of $518,000. (Kaplan Aff. ¶ 7 & Ex. C). Most of the payments to AEI funded Olivier's salary and benefits, and reimbursed him for expenditures he determined were necessary. Similarly, Meschan's law firm received nearly $90,000 for its work on behalf of O.K. (Kaplan Aff. ¶ 8 & Ex. D).[9] Simply put, if any member derived a benefit from O.K.'s operation, it was not Kaplan but the other members.

Kaplan did not divert corporate opportunities from O.K. Defendants have also alleged that Kaplan withheld a corporate opportunity from O.K. that was offered by Ecolab and kept the opportunity himself. This allegation is unsupported. Bruce Cords, the Ecolab representative, testified that his company has not engaged in any transaction with Kaplan or Scientific Associates. (Cords pp. 8-11). Rather, Ecolab lacked interest in O.K.'s technology because it was not fully tested and was in an area that Ecolab did not have a current interest. (Cords pp. 8-10; Kaplan Vol. I p. 108).

Nor is there credible evidence that Kaplan diverted business away from O.K. The purchaser of O.K.'s assets, Scientific Associates, was not incorporated until January 12, 2007, and Kaplan had no discussions with any employee of O.K. about starting or joining a new company that would acquire the assets of O.K. until after the dissolution vote on July 31, 2006. (Kaplan Aff. ¶¶ 9-10).

3. Kaplan did not willfully violate the Operating Agreement.

[9] The sums paid to Tuggle Duggins & Meschan did not compensate Meschan for his time spent on O.K. matters but only time incurred by other members of the firm.

Kaplan fulfilled his obligations under the Operating Agreement. He contributed $200,000 in capital and $500,000 in loans to the company, as required by it. While defendants seek to impose other duties on Kaplan, none are required by the Operating Agreement.

Kaplan was not required to find investors or buyers. Olivier alleges that Kaplan breached fiduciary duties by failing to bring potential buyers to the other members. (Olivier p. 207). Yet the Operating Agreement did not require Kaplan or any other member to find investors or buyers.[10] Bowman also claims that Kaplan had a duty to generate revenue and "make the company prosper." (Bowman pp. 188-89). Again, however, Kaplan was not required to generate revenue and certainly gave no guarantee that O.K. would prosper.

Kaplan was not required to hire lawyers and appraisers to evaluate his own recapitalization proposal. During the January 17, 2006 meeting, Kaplan made a proposal to recapitalize the LLC by converting his growing debt into capital. The other members did not immediately agree to the proposal but asked for more time to review it. Thereafter, they demanded that Kaplan pay for an independent appraiser and attorney to assist them in evaluating his recapitalization proposal. (Bowman pp. 141-46). Yet Kaplan had no duty—under the Operating Agreement or otherwise—to fund other members' analysis of his recapitalization proposal.[11]

Moreover, the other members conceded that they could have sought their own valuation or appraisal and had the ability to seek assistance on their own, but chose not to

[10] Indeed, Olivier conceded that he (Olivier) did not bring any prospect to O.K. (Olivier p. 219).
[11] Kaplan did seek professional advice as to O.K.'s value. While he did not ask for a true business valuation, he did receive an indication from three sources that the company had minimal value. (Kaplan Vol. II, p. 94-95 & Exs. 20 & 21). These opinions were later confirmed by Nate Cann.

do so. (Olivier pp. 135-38; Bowman pp. 145-50). They also knew they could hire an attorney, and actually did so in January 2006 to counsel them on their rights related to O.K., including the recapitalization proposal. (See Olivier Ex. 8). Kaplan's resistance to hiring professionals to assist other members in evaluating his proposal does not constitute a breach of duty.[12]

C. Kaplan's Minority Position Defeats Defendants' Claims.

Defendants' breach of fiduciary duty claim also fails as a matter of law because Kaplan was at all relevant times a minority member in the LLC.

O.K. was a member-managed limited liability company; no one member was the manager. Absent consensus, management decisions were determined by a "Majority in Interest." (Op. Agrmt. p. 10 & Ex. C). As of July 2004, Olivier (37.5%), Bowman (6%) and Meschan (15%) could have outvoted Kaplan at any time.

The other members knew that Kaplan lacked a majority interest. Olivier testified that he was opposed to Kaplan's January 2006 recapitalization proposal in part because it would have provided Kaplan with "full control" of O.K., and with full control, Olivier feared dilution of his interest. (Olivier pp. 155-56). In fact, during the members' meeting on July 31, 2007, the other three members outvoted Kaplan. At that meeting, they voted to appoint Meschan and Olivier as O.K.'s representatives to sell or license O.K.'s technology; Kaplan voted no to that proposal. (Kaplan Aff. ¶ 3). Accordingly, not only did the members understand that Kaplan lacked control, they exercised their control to outvote his minority position.

[12] Further, during the meeting on July 31, 2006, Kaplan offered to pay his pro rata share of an appraisal of O.K., as long as the appraiser was comfortable giving an initial indication that the value of O.K. would exceed $2,000,000. The other three members of O.K. voted against that proposal and continued to refuse to pay their pro rata share of an appraisal. (Bowman p. 146).

D. The Members Discussed all Issues Raised by Olivier and Bowman.

Olivier and Bowman retained counsel in January 2006, who thereafter sent Kaplan a demand letter dated January 26, 2006. (Olivier Ex. 8). Thus, as an initial matter, it is questionable whether fiduciary duties were owed after that time. See, e.g., Piedmont Institute of Pain Management v. Staton Foundation, 157 N.C. App. 577, 583, 581 S.E.2d 68, 72-73 (2003) (relation of trust and confidence is terminated when counsel is retained and duties abrogated).

It is undisputed, however, that Kaplan sought to address each issue raised by their attorney's letter. Kaplan responded on January 31, 2006, suggesting that the members meet and discuss the issues. (Olivier Ex. 9).[13] Bowman then responded to Kaplan, further addressing some of the issues and agreeing to address others at the next member meeting. (Bowman Ex. 11). Bowman prepared his own agenda for the next meeting on February 6, 2006, and the minutes of that meeting prepared by Meschan reflect detailed discussion about the issues raised by Olivier and Bowman. (Bowman Exs. 12, 13).

These records show that the members engaged in a series of frank discussions. Concerns raised by Olivier and Bowman were debated and addressed.[14] Olivier and Bowman now take issue with many of the decisions and votes. Yet disagreement over outcomes cannot form the basis for a breach of fiduciary duty claim.

[13] Meschan wrote the first draft of Kaplan's letter. (Meschan Vol. II, pp. 77-80 & Ex. 8).
[14] The minutes of the January 17, 2006 meeting further reflect the members' discussion about issues raised by Olivier and Bowman, a point they do not dispute. (Bowman pp. 155-60 & Exs. 9, 11).

IV. THE OTHER COUNTERCLAIMS ASSERTED BY DEFENDANTS OLIVIER, BOWMAN AND AEI FAIL AS A MATTER OF LAW.

A. The Constructive Fraud Claim Fails as Kaplan Derived no Benefit.

In order to defeat a motion for summary judgment on a claim for constructive fraud, defendants must forecast evidence of a relationship of trust and confidence that led up to and surrounded the consummation of a transaction in which Kaplan took advantage of his position of trust to the detriment of defendants. Barger v. McCoy Hillard & Parks, 346 N.C. 650, 666, 488 S.E.2d 215, 224 (1997). A central element of constructive fraud is that the person sought to benefit himself from the transaction. Id.

There is no evidence that Kaplan sought to benefit or did benefit from any transaction involving O.K. [15] As indicated *supra*, Kaplan did not divert corporate opportunities from O.K. to himself, and the defendants' suspicion of a "side deal" with Ecolab is wholly unsupported. (Cords pp. 8-10). Accordingly, the constructive fraud claim cannot survive summary judgment.

B. Kaplan did not Engage in Fraud.

Olivier and Bowman's claim that Kaplan engaged in fraud also fails. Actual fraud requires: (1) false representation or concealment of a material fact, (2) reasonably calculated to deceive, (3) made with intent to deceive, (4) which does in fact deceive, (5) resulting in damage to the injured party. McGahren v. Saenger, 118 N.C. App. 649, 654, 456 S.E.2d 852, 855 (quoting Ragsdale v. Kennedy, 286 N.C. 130, 138, 209 S.E.2d 494, 500 (1974), disc. rev. denied, 340 N.C. 568, 460 S.E.2d 318 (1995)).

[15] Indeed, Bowman testified he did not even understand constructive fraud. According to Bowman, the only factual basis for a constructive fraud claim related to a paper that Kaplan asked him to sign. Bowman did not sign the paper and never heard anything about it again. (Bowman pp. 197-98).

Olivier and Bowman contend Kaplan committed fraud by allegedly representing at the time of the formation of O.K. that the company would focus on the development, manufacture and sale of the denitrator technology. (Counterclaims ¶ 56). They further contend that Kaplan represented that $700,000 would suffice to develop and sell the denitrator technology. (Counterclaims ¶ 56; see also Bowman pp. 191-97).

Bowman's testimony undermines these allegations. He testified he did not know whether Kaplan believed $700,000 was a sufficient amount:

> Q: You don't have any reason to believe that Leonard Kaplan had any belief that $700,000 was not sufficient to proceed forward with the business operations of O.K. Technologies, do you?
>
> A: Well, I can tell you that Leonard Kaplan personally told me that it was going to cost somewhere around $300,000 for a good patent on something. That's what originally got us to take Leonard's assistance, because he convinced me that I was never going to be able to afford a patent by myself and that myself and Laurent working on the patent of the denitrator alone was futile, that we would never have a solid patent and he convinced me that it was going to cost $300,000 for a patent. And that's when I said wow, maybe we do need a little bit of help. So that's $300,000 out of the $700,000 and he knew that very well, because he told me himself.
>
> * * *
>
> Q: He didn't keep that to himself; he shared that with you, correct?
>
> A: He did. Now, as to whether or not Leonard Kaplan had any belief that the remaining $400,000 was enough to fund the rest of the venture separate of the legal issues, that I don't know.
>
> Q: You don't have any knowledge that he believed it to be insufficient to go forward with the O.K. Technologies business, do you?
>
> A: I don't have any knowledge that that wasn't enough capital for just the denitrator for specifically just the denitrator the home aquarium use that we started with at the time that we started.

(Bowman pp. 194-95).

Even if Kaplan made the representations stated in paragraph 56 of the counterclaims, which Kaplan denies, Olivier and Bowman cannot show reliance on them nor intentional deception on Kaplan's part. Both Olivier and Bowman understood from the beginning that the company was focusing its efforts on developing the denitrator technology beyond manufacturing the devise itself. (Bowman pp. 192-93). Indeed, as a part of the formation of the company, Olivier agreed to assign all future improvements and ideas for improving the technology and further inventions related to it, clear indicia that further development was contemplated at the outset. (Op. Agrmt. p.4). Thereafter, as early as March 2004, Olivier and Bowman completed a strategic plan for developing the denitrator technology into specific areas of development, including aquariums, animal waste and aquaculture. (Bowman pp. 69-73 & Ex. 2). Their strategic plan projected the funds required to advance each area of development and recommended that the company proceed simultaneously with the aquarium and aquaculture projects. (Bowman Ex. 2). Further, as discussed *supra*, the members continued to vote on the company's priorities and provide input on how funds were spent. (See e.g., Bowman Exs. 4, 9). Finally, Olivier admits that he did not object to the funding process and continued to receive his paycheck. (Olivier p. 227).

These circumstances show that Olivier and Bowman did not rely on alleged pre-incorporation statements by Kaplan. Nor were they deceived by them. Rather, the evidence shows that they fully participated in the strategic decisions and direction of the

company, which undisputedly involved much more than selling denitrators. Accordingly, the fraud claim fails.[16]

C. An Unfair and Deceptive Trade Practices Claim is Not Appropriate for Matters Involving the Internal Affairs of an LLC.

To sustain a claim under the North Carolina Unfair and Deceptive Trade Practices Act ("UDTPA"), defendants must establish that (1) Kaplan committed an unfair or deceptive act or practice, (2) in or affecting commerce and (3) that defendants were injured as a result. Pleasant Valley Promenade v. Lechmere, Inc., 120 N.C. App. 650, 464 S.E.2d 47 (1995). Although the UDTPA's language is broad, "the Act is not intended to apply to all wrongs in a business setting." HAJMM Co. v. House of Raeford Farms, Inc., 328 N.C. 578, 593, 403 S.E.2d 483, 492 (1991). This is particularly so where the alleged wrong relates to the internal corporate management and internal affairs of a business entity. Haynes v. B&B Realty Group, LLC, 179 N.C. App. 104, 633 S.E.2d 691 (2006); Wilson v. Blue Ridge Elec. Membership Corp., 157 N.C. App. 355, 578 S.E.2d 692 (2003); Garlock v. Hilliard, 2000 NCBC 11, ¶ 24 (N.C. Super. Aug. 22, 2000) (claims based on formation of corporation did not suffice to state a UDTPA claim).

Moreover, in enacting the UDTPA, the General Assembly "intended to establish an effective private cause of action for aggrieved consumers in [North Carolina] . . . because common law remedies had proved often ineffective." Marshall v. Miller, 302 N.C. 539, 543, 276 S.E.2d 397, 400 (1981); see also Bhatti v. Buckland, 328 N.C. 240, 245, 400 S.E.2d 440, 443 (1991) (the purpose of the UDTPA "is to declare, and to provide civil legal means to maintain, ethical standards of dealings between persons

[16] Bowman also indicated there was fraud associated with the Bill of Sale. (Bowman p. 190-91). Yet Eric Hardin prepared the Bill of Sale, not Kaplan. (Hardin pp. 26-27). Accordingly, there cannot be fraud on Kaplan's part with respect to the Bill of Sale or its terms.

engaged in business . . . and the consuming public in this State"). This case does not involve consumers or the general public in any way, and thus falls outside the scope of the UDTPA. Accordingly, defendants' UDTPA claim fails as a matter of law.

D. The Negligent Misrepresentation Claim Fails as a Matter of Law.

Defendants' negligent misrepresentation claim also fails. Negligent misrepresentation requires the following: (a) a definite and specific representation; (b) the representation was materially false; (c) the representation was made with knowledge of its falsity or in culpable ignorance of its truth; (d) it was made with fraudulent intent; (e) it was reasonably relied upon by the other party; and (f) there was actual loss flowing from the alleged misrepresentation. Lillian Knitting Mills Co. v. Earle, 237 N.C. 97, 74 S.E.2d 351 (1953); see also Raritan River Steel Co. v. Cherry, Bekaert & Holland, 322 N.C. 200, 206, 367 S.E.2d 609, 612 (1988) ("[N]eglient misrepresentation occurs when a party justifiably relies to his detriment on information prepared without reasonable care by one who owed the relying party a duty of care.").

As an initial matter, it does not appear that a negligent misrepresentation theory applies to internal disputes over the direction of a limited liability company. Oberlin v. Slavin, 2000 NCBC 6, ¶ 28 ("Negligent misrepresentation cases typically involve claims against a party who was hired to supply information or provide an analytical report. . . . In fact, the theory of negligent misrepresentation has traditionally been applied to situations where a third party relied upon information prepared by one party for another, and was damaged as a result."); rev'd on other grounds, 147 N.C. App. 52, 554 S.E.2d 840 (2001). Even assuming a claim of negligent misrepresentation is appropriate in this case, there is no evidence that Kaplan made any representation that was materially false.

Moreover, when the party relying on the alleged misleading representation "could have discovered the truth upon inquiry, the complaint must allege that he was denied the opportunity to investigate or that he could not have learned the true facts by exercise of reasonable diligence." Hudson-Cole Dev. Corp. v. Beemer, 132 N.C. App. 341, 346, 511 S.E.2d 309, 313 (1999). Not only does the Complaint in this case fail to allege that defendants were denied opportunities to investigate, the undisputed facts show that defendants did investigate. They retained counsel and made demands on Kaplan. (Olivier Ex. 8). They created meeting agendas. (Bowman Ex. 8; Olivier Ex. 10). They sought and received financial records. (Bowman Ex. 14). They participated in member meetings. (Bowman Exs. 10, 12, 13). Under these circumstances, the claim of negligent misrepresentation fails as a matter of law.

V. DEFENDANTS CANNOT RESCIND THEIR ASSIGNMENT TO O.K.

Olivier and Bowman seek to rescind their September 3, 2003 assignment of technologies to O.K. (Counterclaims, ¶ 81). Rescission is an equitable remedy that does not exist when the breach is not substantial and material and does not go to the heart of an agreement. Childress v. Meyers Trading Post, Inc., 247 N.C. 150, 156, 100 S.E.2d 391, 394 (1957) (citations omitted). North Carolina law does not favor rescission as a remedy. Jones v. Griggs, 223 N.C. 279, 282, 25 S.E.2d 862, 864 (1943) ("An agreement lawfully entered into and based on consideration should not be set aside except for gravest reasons.").

As Kaplan breached no obligation or duty, defendants are not entitled to rescind their assignment to O.K. and return the parties to pre-incorporation status. Moreover, this Court previously approved the Receiver's sale of O.K.'s assets to Scientific Associates.

The Court's approval of the sale occurred after all parties were given ample opportunity to object and be heard.[17] While the proceeds from the sale remain at issue, the assets of O.K. have been sold and now reside with a third party that is not a party to this case. Under these circumstances, rescission is not a proper remedy.[18]

VI. KAPLAN'S INDEPENDENT CONTRACTOR AGREEMENT WITH O.K. IS IMMATERIAL TO RESOLVING THE CLAIMS.

In his amended Answer, Meschan contends that the Independent Contractor Agreement between Kaplan and O.K., dated September 3, 2003, could not be assigned by the Receiver to Scientific Associates, LLC. Based on this premise, Meschan argues that Kaplan has violated the noncompetition covenant contained in the Agreement by virtue of his ownership of Scientific Associates, LLC.

Even assuming *arguendo* that the Agreement includes an enforceable restrictive covenant, Meschan's attempt to offset O.K.'s debt to Kaplan fails as a matter of law. First, the Receiver assigned all rights and obligations under the Independent Contractor Agreement to Scientific Associates, Kaplan's designee and the purchaser of the O.K. assets. The Receiver states:

> The Receiver contends that the Kaplan [Independent Contractor Agreement] was an asset of the Company, title to which passed to the Receiver upon his appointment pursuant to N.C.G.S. § 1-507.3. Upon the consummation of the asset purchase, title to the Kaplan Agreement, along with the title to all of the Company's assets, in whatever form, passed to the purchaser. There are no assets, tangible or intangible, remaining in the receivership estate for administration by the Receiver.

See Receiver's Response, filed September 18, 2007. Moreover, the Court approved the sale of assets to Kaplan's designee, and prior to court approval, no party objected to the

[17] Olivier and Bowman did not attempt to enjoin the Receiver's sale process or sale to Kaplan's designee and their time for doing so has expired.

[18] Meschan also opposes Olivier's and Bowman's request to rescind their assignment. See Meschan Response to Crossclaims, dated March 12, 2007.

sale on the basis that Kaplan would somehow violate a prior Independent Contractor Agreement by virtue of his status as the purchaser.

Finally, this Court recently noted that a covenant not to compete is generally assignable, in part because such assignment facilitates and protects capital investment. Better Bus. Forms & Products v. Craver, 2007 NCBC 34, ¶ 29 (N.C. Super. Nov. 1, 2007) (citing Keith v. Day, 81 N.C. App. 185, 195, 343 S.E.2d 562, 568 (1986) and Reynolds & Reynolds Co. v. Tart, 955 F. Supp. 547, 556 (W.D.N.C. 1997)). Thus, contrary to Meschan's conclusory statements that covenants such as those contained in the Independent Contractor Agreement cannot be assigned, the Court has held to the contrary.

CONCLUSION

For the reasons discussed herein, Kaplan respectfully requests that his Motion for Summary Judgment be granted.

This the 14th day of December, 2007.

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NORTH CAROLINA

GUILFORD COUNTY

IN THE GENERAL COURT OF JUSTICE
SUPERIOR COURT DIVISION
06 CVS 10500

LEONARD J. KAPLAN,

Plaintiff,

v.

O.K. TECHNOLOGIES, LLC, LAURENT OLIVIER, DAVID F. MESCHAN, JEFFREY BOWMAN, and AQUATIC EVOLUTION INTERNATIONAL, INC.,

Defendants.

CERTIFICATE OF SERVICE

This is to certify that on December 14, 2007, the undersigned counsel for Plaintiff filed the foregoing Brief in Support of Motion for Summary Judgment with the North Carolina Business Court using the Electronic Filing system, which will send notification of such filing to the following: David F. Meschan, Pro Se; James W. Miles, Jr., Counsel for Defendants Laurent Olivier, Jeffrey Bowman and Aquatic Evolution International Inc.; and James C. Lanik, Counsel for the Receiver of OK Technologies, LLC, William P. Miller.

/s/ Manning A. Connors
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