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SHORT FORM ORDER

INDEX No. 6588/13

SUPREME COURT - STATE OF NEW YORK
I.A.S. COMMERCIAL PART 45 - SUFFOLK COUNTY

PRESENT:

Hon. THOMAS F. WHELAN
Justice of the Supreme Court

MOTION DATE 8/30/13
ADJ. DATES 11/15/13
Mot. Seq. # 005 - MG
CDISP Y____ N XX

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KNET, INC., THOMAS GROGAN, both individually and on behalf of INTERCEPTOR IGNITION INTERLOCKS, INC. and GARY MELIUS,

Plaintiffs,

-against-

JOHN RUOCCO, DENNIS DONNELLY and ROSEMARIE SYLVESTER,

Defendants.

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Upon the following papers numbered 1 to 21 read on this motion by the plaintiffs for preliminary injunctive relief; Notice of Motion/Order to Show Cause and supporting papers 1 - 8; Notice of Cross Motion and supporting papers ____; Answering Affidavits and supporting papers 9-11; Replying Affidavits and supporting papers 12-13; Other 14-15 (memorandum); 16-17 (reply memorandum); 18 (post-hearing brief); 19 (memorandum); 20 (hearing transcripts); 21 (exhibits); and after hearing counsel in support of and opposition to the motion, it is

ORDERED that this motion (#005) by the plaintiffs for an order granting them preliminary injunctive relief, or in the alternative, partial summary judgment on the Eighth Cause of Action of their complaint, is considered, after hearing under CPLR 2018, 3212(e), 6311 and 6312(c), and is granted, as indicated below.

Plaintiff Gary Melius ("Melius") is the sole shareholder of KNET, Inc. ("KNET"), while plaintiff Thomas Grogan ("Grogan") is the sole member of the Grogan Group, a limited liability company whom defendant John Ruocco ("Ruocco") on behalf of Interceptor Ignition Interlocks, Inc. ("Interceptor"), retained in 2005 as Interceptor's state sales representative.

Interceptor is in the business of providing solutions for drunk driving through the lease and sale of alcohol testing and car ignition interlock systems.

The order to show cause, dated August 16, 2013, brought by plaintiffs, seeks to void all but 500,000 of the shares of Interceptor issued to Ruocco and all the shares of Interceptor issued to Ruocco's sister, Rosemarie Sylvester ("Sylvester"), or to enjoin said defendants from voting at the shareholder meetings, except that Ruocco may vote his remaining 500,000 shares pending the outcome of this litigation. Alternatively, plaintiffs seek an order granting partial summary judgment on Plaintiffs' Eighth Cause of Action, pursuant to CPLR 3212(e), based upon defendants undisputed failure to provide sufficient consideration for their shares. Finally, KNET, seeks to correct its ownership interest on Interceptor's shareholder list, pursuant to Bus. Corp. Law §619.

However, to understand how this litigation got to this stage and why the Court decided to hold a hearing to ascertain an accurate count of the disputed shares of the parties, the Court must detail the procedural history that preceded this application.

The legal dispute between the parties commenced when the plaintiffs sought a preliminary injunction compelling Ruocco to hold a special meeting of shareholders of Interceptor on May 1, 2013 at 11:00 a.m. at its company offices, for the purpose of electing a three member board of directors. The plaintiffs alleged that no annual meeting of shareholders, no election of directors, and no valid acts of corporate governance were ever undertaken by Ruocco, the incorporator and de facto president of Interceptor and his sister, Sylvester.

Ruocco claimed that KNET was not a shareholder of Interceptor due to contractual failings on its part. Ruocco further asserted that he caused the convening of a "special" meeting of the board of directors on March 5, 2013, at which, two directors were added to the board. One of those two new directorships was filled by Ruocco upon his nomination of his sister, Sylvester. Ruocco also alleges that the two member board went on to schedule a special meeting of shareholders for May 1, 2013, by notice issued by him to all shareholders. However, the plaintiffs established that there was no due service of any notice of the May 1, 2013 shareholders meeting upon KNET. The plaintiffs established that KNET's shareholder status was irrefutable, although the number of stock shares to which it is entitled under certain agreements was not certain due to the absence of the disclosure of the number of all outstanding shares and the entities or persons owning same.

The Court found, in its April 12, 2013 Order, the existence of special circumstances arising from the recent machinations of Ruocco, in his capacity as a de facto director of Interceptor, which warranted the issuance of the limited mandatory injunctive relief requested, and directed the defendants to hold a special meeting of the shareholder of Interceptor on May 1, 2013. Ruocco was further directed to provide plaintiffs with a complete and accurate list of the names of all shareholders, the number of shares owned by them, the date each shareholder was issued its shares, all known post office addresses of each shareholder, and any electronic addresses known to Ruocco or Interceptor.

However, contrary to the direction of the Court, the special meeting of the shareholders of Interceptor did not occur on May 1, 2013. The meeting was closed without a vote of the shareholders in attendance personally or by proxy. Nevertheless, after the various shareholders left the aborted meeting, including the plaintiffs, Ruocco and Sylvester held a vote on their proposed slate of directors following the close of the court-ordered meeting. This surreptitious election by Ruocco and Sylvester

resulted in the election of their nominee, William Catacasinos, Jr., as a third director and a de facto confirmation of Ruocco's prior designation of himself and Sylvester as directors, which occurred at proceedings previously conducted by them without a meeting of the shareholders.

Upon the Court's review of the record, including the minutes of the May 1, 2013 special shareholders meeting, the Court found that the challenged actions resulting in a confirmance of the prior designation of Ruocco and Sylvester as directors and the new election of William Catacasinos. Jr., as a director were improper, ultra vires and otherwise violative of the corporate governance documents. The impropriety of such proceedings was evident from the fact that they were conducted after the close of the special shareholders meeting that was the subject of the prior order of this court dated April 12, 2013.

The court, in its August 27, 2013 Order, found these circumstances sufficiently extraordinary to warrant the granting of mandatory injunctive relief in the form of the removal of Sylvester and William Catacasinos. Jr., and the removal of Ruocco from their directorship offices and a further order precluding them from acting in the capacity of a director until such time as they are, if ever, duly elected by a vote of the shareholders entitled to vote at the reconvened special shareholders meeting then scheduled for September 11, 2013 or any adjourned date thereof. The Court did permit Ruocco to remain as the de facto president of Interceptor and as such, carry on its regular business, but only in the ordinary course thereof, until such time as the office of president is filled in accordance with the governing documents of Interceptor.

Prior thereto, in an effort to resolve the conflict by full disclosure of pertinent documentation, this Court directed defendants, by order dated June 5, 2013, to make available for inspection and copying by the plaintiffs of all books and records in keeping with BCL § 624(b) and (e). An additional Stipulation/Order was issued on June 21, 2013 mandating financial back-up and shareholder list back-up by June 24, 2013, with a conference call scheduled for June 26, 2013, all in a effort to reschedule a new shareholders meeting on or before August 1, 2013. That conference call resulted in the issuance of a So-Ordered disclosure letter, dated June 26, 2013, which identified 26 items that the defendants agreed to turn over to the plaintiffs. Item No. 10 required production of "All documents showing the consideration given or amounts paid by Defendants Sylvester and Ruocco for shares issued to them (or entities they control), and all agreements relating to such issuance of shares..."

However, plaintiffs complained in letters to the Court that full disclosure was not forthcoming and that the items that were provided did not resolve the outstanding issue of the names of all shareholders, the number of shares owned by them, and the date each shareholder was issued its shares. The pending motion was the direct result of the conflicting information provided by defendants.

Requests for a hearing were entertained by the Court by Order dated September 20, 2013 and it was agreed that the hearing would commence on October 8, 2013. Prior to the hearing, by Order dated September 27, 2013, the Court dismissed the two counterclaims advanced in the defendants' amended answer. As noted in that Order, Ruocco retained KNET in 2010 under a written contract to develop the business of Interceptor, that is, the Business Development Agreement and as a consultant for purposes of finding financing under the terms of a separate writing entitled the "Consulting Agreement".

The defendants' answer contained two counterclaims. The first targeted plaintiffs, KNET and Melius, charging them with breaching the terms of the 2010 Consulting Agreement wherein they were allegedly obligated to obtain two million dollars in financing from UBS Financial Services ("UBS"). The Second counterclaim, sought money damages from plaintiff, Thomas Grogan, due to his purported breach of those portions of a 2005 sales services agreement.

The plaintiffs sought dismissal of these counterclaims pursuant to CPLR 3211(a)(1) and (a)(7), claiming that plaintiff Melius had no contract with Interceptor and that KNET did not obligate itself under the Consulting Agreement to secure a two million dollar loan from UBS. Instead, the Consulting Agreement permitted KNET to secure financing from UBS or from "another source reasonably acceptable to the plaintiff" which KNET did, when it secured and Interceptor accepted and utilized, a 1.5 million dollar line of credit from the Flushing Federal Savings Bank. Dismissal of the counterclaim against Grogan was sought because he had no contract with Interceptor and was not liable for any breach of the sales services contract Interceptor had with his company, the Grogan Group.

The Court, in its Order dated September 27, 2013, held dismissal of the defendants' First counterclaim was appropriate, in which plaintiffs KNET and Melius were charged with breaching those portions of the Consulting Agreement wherein they allegedly promised to secure two million dollars in financing from UBS. A plain reading of the Consulting Contract revealed that its provisions obligate neither KNET nor Melius to secure financing from UBS. These contractual provisions refuted defendants' allegations of any breach on the part of KNET, the sole obligor under such contract. Dismissal of the defendants' Second counterclaim was also warranted.

As can be seem from the above history, tremendous effort has been expended in seeking to accomplish what should be a simple task, that is, the holding of a special meeting of shareholders of Interceptor. In fact, the court-ordered shareholder meeting was aborted by the actions of the defendants and the direction of the Court was ignored, resulting in the voiding of the purported election of Directors. It was agreed that without an accurate accounting of shareholders and their holdings, which had not been forthcoming, any future shareholder meeting would be of little value and would just leave the parties in the same legal stalemate.[1]

The hearing to ascertain the respective shares of the shareholders commenced on October 8, 2013 and concluded on October 9, 2013. The parties were directed to submit post-hearing briefs by November 12, 2013. Upon review of the papers, the Court found the hearing to be necessary pursuant to CPLR 2018, 3212(e), 6311 and 6312(c). What follows is based upon the exhibits offered, the testimony of the witnesses, and, importantly, this Court's determination as to the credibility of each witness.

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[1] Although at the commencement of the hearing defendants' counsel objected to the scope thereof, he did agree that the challenge to his clients claim of ownership of 8 million shares was proper. "They're claiming that my clients do not own the shares, so that we'll go forward on. I have no problem on that..." (Tr., pp. 10-11).

The first witness was Melius, the sole shareholder of KNET. Melius is a well-known Long Island real estate and business figure, who is involved in various political and philanthropic ventures, as well.[2] He introduced into evidence the June 6, 2010 Business Development Agreement (*see* Pl. Ex 1) and the stock certificate issued to KNET of 2,803,214 shares (*see* Pl. Ex. 2). Those shares represent compensation under the agreement upon "the enactment or amendment of laws in at least one (1) state within the United States ... to effect the inclusion of Real-Time Data Transmission as a prerequisite to interlock use and/or certification" (Pl. Ex. 1, par. 3[a][I]). It is conceded that such a law was passed in 2010 in Suffolk County (*see* Melius aff., dated May 13, 2013, par. 17; *see also* Motion, Ex. W, Letter dated October 26, 2010).

The Court notes that in his Affidavit dated June 7, 2013, Ruocco states that "KNET was issued 2,803,214 shares pursuant to Section 3(a)(1). Melius had assisted in the adoption of Leandra's Law and earned those shares." The shares are reflected in stock certificate number 100 (*see* Pl. Ex. 2).

With regard to additional items of compensation under the Business Development Agreement, Melius did not believe that KNET had fully satisfied the condition under paragraph 3(a)(ii) which provided for the issuance of 934,405 shares upon introduction to one or more public officials and one or more automobile insurers. However, Melius did believe that he satisfied the condition under paragraph 3(a)(iii) which provided for the issuance of 934,405 shares upon the company becoming certified as an Ignition Interlock Provider ("IIP") in at least one (1) state where the company is not yet certified (*see* Tr., p. 93).

Melius also introduced into evidence the Consulting Agreement (*see* Pl. Ex 3), mentioned above under the discussion of this Court's Order of September 27, 2013, which dismissed the defendants' First counterclaim. As noted above, that agreement called upon KNET to "secure financing from UBS Financial Services, Inc. ("UBS"), and/or another source reasonably acceptable to the Company in an amount sufficient, and pursuant to terms, reasonably acceptable to the Company" (Pl. Ex 3, par [1][a][i]). Compensation under the Agreement (*see* Pl. Ex 3, par [3][a][I]) was established as 3,176,976 shares upon KNET securing a financing letter or commitment, upon the company's acceptance (*see* Tr., p. 106).

It is agreed that a 1.5 million dollar line of credit was obtained from the Flushing Federal Savings Bank, upon a loan guaranty signed by Melius, which financing Interceptor accepted and utilized. Melius sought to introduce an unsigned amendment to the Consulting Agreement that set forth a differing compensation formula of stocks, based upon a percentage of outstanding stocks, but Ruocco objected to its introduction and it was excluded. What was admitted was stock certificate No. 121 issued on December 2, 2011 to KNET as owner of 382,158 shares of stock (*see* Pl. Ex. 6), as partial payment under the Consulting Agreement.[3] While testimony was offered as to the unsigned

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[2] *See e.g.* Larocco, *Developer Downplays Political Influence in Dale Case*, Newsday, December 22, 2013.

[3] It was defendants position at the hearing that these shares were issued pursuant to the signed agreement and that the excluded amendment was not a signed agreement (*see* Tr., p. 40).

amendment, the Court disregarded same since no signed copy was ever produced and even the version set forth in the motion papers is unsigned (*see* Ex. S, unsigned letter, dated November 22, 2010).

While a document was admitted into evidence that suggested that Melius was willing to cosign on a $5,000,000 loan (*see* Def. Ex. D), the Court dismisses the claim since the document was not generated by Melius and it constitutes an improper use of extrinsic evidence which is being sought to interpret the clear and unambiguous language of the Consulting Agreement as detailed in this Court's Order of September 27, 2013. Furthermore, it runs counter to defendants' dismissed pleading, that is, the first counterclaim, which claimed that KNET was obligated to obtain two million dollars in financing from UBS.

In his Affidavit dated June 7, 2013, Ruocco acknowledged that KNET was issued shares under the Consulting Agreement, which is contrary to his previously plead claim that the Agreement called for two million in financing and the new claim at the hearing of five million in financing.

Melius testified that Interceptor owed KNET over $500,000 in expenses and loans that had been advanced to keep the company solvent and that the sums were repaid by Interceptor on or before March 2011, as reflected in the statement of bills admitted as Pl. Ex. 7. He did admit that Sylvester was involved with the operations of KNET (*see* Tr., p. 59).

Melius was questioned as to his due diligence in entering into the Agreements, in particular, Schedule 4(a)(ii) attached to the Business Development Agreement, which set forth the then current shareholder list and which noted a total of 8 million in shares to the defendants. It was also noted that under the Representations and Warranties provisions of the Business Development Agreement, Interceptor represented that 10,838,000 shares are issued and outstanding. Melius testified that he did not believe that he ever got the full books and records of Interceptor (*see* Tr., p. 62), that the information was supplied by Ruocco (*see* Tr., p. 80), and that his focus as of the time of the agreements was not to challenge the reliability of the individual that he was entering into an agreement with (*see* Tr., p. 84), but to secure his own compensation (*see* Tr., p. 71). Moreover, as noted at the time, these are representations and warranties of Interceptor upon which KNET is relying in agreeing to provide its services in exchange for the compensation provided for under the agreement (*see* Tr., p. 70).

Overall, the Court found the Melius testimony, while self-serving at times, to be credible. He provided governmental access and personal and bank financing to Interceptor at a time when it needed such assistance and the infusion of cash.

The next witness to testify was Grogan, who first worked for Safe Start, the predecessor to Interceptor, in August of 2005. He was hired to provide funding through private placement at two dollars a share. On August 6, 2006 he personally bought 7,500 shares in Safe Start for $15,000 (*see* Pl. Ex. 9-A), for which he never received a stock certificate (*see* Tr., p. 123). Additionally, as part of his compensation, he received 50,000 shares in Interceptor on May 15, 2010 (*see* Pl. Ex. 8). He explained that the first investor that he brought to the company was a Byron Gray, by Subscription Agreement dated October 18, 2005, for the purchase of 25,000 shares at a price of $50,000 (*see* Pl. Ex. 9). The large compilation of Subscription Agreements, submitted as Pl. Ex. 9, reveals two investors in 2005 and ten in 2006, under the predecessor, Safe Start. In 2007, there were 11 investors under the Interceptor name, in 2008 there were 11 investors, in 2009 there were 5 investors, in 2010 there were 32 investors,

and in 2011 there were 10 investors. Every investor paid two dollars a share. Grogan left Interceptor in May of 2012.

Grogan also testified that while he worked there, various states were certified as an IIP including Vermont in 2011 and Rhode Island the same year (*see* Tr., pp. 137-38). The Court found Grogan to be a credible witness and since he owned stock in the company as early as August of 2006, he certainly possesses standing to challenge the stock ownership, or lack thereof, of the defendants.

Plaintiffs next called Sylvester to testify. She testified that without a written agreement (*see* Tr., p. 148), $40,000 was taken from a fund and that she received 4,000,000 shares (*see* Tr., p. 144). She believed it happened within the last two years and there were two issuances of stock (*see* Tr., p. 145). When confronted with an exhibit that showed the issuance of shares to her in May of 2007, she stated "I don't think that was in '07" (Tr., p. 150). Sylvester could not explain why there were two issuances of stock, separated by three years, nor could she explain why investors were paying two dollars a share, while she received four million shares for a claimed transfer from a loan account of just $40,000.

Sylvester admitted that there was but one shareholder meeting in the history of Interceptor, the one ordered by the Court (*see* Tr., p. 153). She testified that she loaned the company between 2003 and 2007 about $166,000 and thereafter another $100,000. Documentation was only offered as to the initial amount (*see* Def. Ex. C). Upon rehabilation from her own counsel (*see* Tr., pp. 158-9), Sylvester was reminded that the claimed transfer from the loan account to a capital stock account occurred in October of 2006. She had no explanation as to why it took four years to get the stocks she claims were due to her (see Tr., p. 163). Sylvester offered very little to resolve the issues of this hearing and could not explain many of the actions undertaken by Ruocco, her brother. There is little doubt that over the years she has donated sums of money to her brother's venture but possessed little knowledge as to the workings of Interceptor.

Plaintiffs then called Ruocco. As will be detailed, upon a full review of his testimony, the Court must conclude that nearly all of his testimony was incredible and simply an after-the-fact attempt to backfill for previous actions undertaken in his running of Interceptor.

Originally, on February 15, 2000, the company was called Safe Start Inc., and it was authorized to issue 200 shares of common stock, at no par value (*see* Pl. Ex. 10). Roucco claimed to be the sole shareholder but could not recall if a stock certificate was issued (*see* Tr., p. 169-70). The company name was changed to Interceptor upon a filing with the Secretary of State on September 29, 2006. The document states that the action was undertaken "by a vote of all outstanding shares entitled to vote..."(*see* Pl. Ex. 12). Roucco testified that he was the sole shareholder and that he owed all 200 shares of stock at that time (*see* Tr., p. 173). However, no stock certificate verifying that fact was ever produced.

On February 13, 2007, with the assistance of counsel, Harold Paul (*see* Tr., p. 175), the Certificate of Incorporation was amended to reflect the following (Pl. Ex. 13):

> Two hundred (200) common shares authorized at no par value will change at a rate of 1-to-50,000 resulting in ten million (10,000,000) common shares authorized at $.001 par value.

> There are currently ten (10) issued and outstanding shares. This will change at a rate of 1-to-50,000 resulting in five hundred (500,000) common shares issued and outstanding at $.001 par value.
>
> There are currently one hundred ninety (190) unissued shares. This will change at a rate of 1-to-50,000 resulting in nine million five hundred thousand (9,500,000) common shares unissued at $.001 par value.

The filed document states that it was authorized "by the unanimous written consent of the holders of all outstanding shares" (Pl. Ex. 13) and Ruocco again testified that he owned all the shares. However, as reflected in the Certificate (*see* Pl. Ex. 13), signed by Ruocco, only 10 common shares were issued as of February 13, 2007, which converted to his owning 500,000 common shares of Interceptor. When questioned about the change and the language noting "ten (10) issued and outstanding shares" and "one hundred ninety (190) unissued shares," Ruocco claimed that "It's obviously a typo from the secretary" (Tr., p. 177). He refused to conceded that he only owed ten shares, as reflected in the filed document (*see* Tr., pp. 178-79).[4]

When questioned about his claim of a transfer of $40,000 from his and his sister's loan accounts to purchase shares in October of 2006, which was five months before the Certificate Amendment (*see* Pl. Ex. 13), from which they each claimed to have purchased 4,000,000 shares, Ruocco still claimed to own all of the pre-existing shares of the company (*see* Tr., pp. 180-81).

Yet, as detailed above, under the testimony of Grogan, and as disclosed in the compilation of Subscription Agreements signed by Ruocco (*see* Pl. Ex. 9), various investors, including Byron Gray who purchased 25,000 shares on October 18, 2005, were paying two dollars a share a full year and a half before the Certificate Amendment was ever filed (see Tr., pp. 182-83). The testimony included such inconsistencies as the following (Tr., pp. 186-87):

> Q. Mr. Ruocco, if the company only had 200 shares in 2005, how did you sell Mr. Gray 25,000 shares?
>
> A. We'd have to find that out from Harold Paul. He was the SEC attorney who prepared all of the documentation.
>
> Q. But you concede that until 2007 the company only had 200 shares, correct?
>
> A. According to the document that was filed, yes. But Harold Paul, as I said is the SEC attorney, and he handled the private placement and the subsequent issuance of that amount of shares.

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[4] When questioned by his own attorney on this issue, Ruocco still insisted that it was a typo and blamed his "SEC attorney's secretary," despite the Court's skepticism (*see* 2d Tr., pp. 40-1).

While insisting that he owed all 200 shares and then all 10,000,000 shares after the February 2007 Certificate Amendment (*see* Tr., p. 188), he could not explain what shares the company had left to sell thereafter (*see* Tr., pp. 188-89). Moreover, with regard to the claimed transfer of $40,000 from the loan account on October 31, 2006, which was used to pay for 4 million shares (that did not exist until the February 13, 2007 Certificate Amendment), documentation from the company's books and records disclosed that there did not exist $40,000 in the loan account to transfer and that for that year the loan account was in the negative (*see* Pl. Ex. 16; *see also* Tr., p. 192). Although Ruocco stated that he owed all 10,000,000 shares as of February-May, 2007, he could not explain how the claimed transfer, with his sister, of $80,000 from a loan account got him those shares (*see* Tr., pp. 197-98).

With regard to the shareholder list set forth as a schedule of the Business Development Agreement (*see* Pl. Ex. 1), Ruocco could not explain if the notation of the issuance of 1.5 million shares was based on the payments made back in October of 2006 (*see* Tr., p. 200). Ruocco then offered some of the most confusing and uncooperative testimony imaginable when describing his ownership of all 10,000,000 shares, or 8 million shares, or why only a limited number of shares were issued in May of 2007, or then in 2010, and why his sister received the shares she did (*see* Tr., pp. 201-05; *see also* pp. 217-18). In essence, Ruocco agreed with the question that he issued the 1.5 million shares to himself and his sister because he wanted to maintain control of the company (*see* Tr., p. 206).

Questioning by the Court as to where the 1.5 million shares for each defendant came from failed to provide sufficient answers (Tr., p. 210):

> THE WITNESS: It came out of the balance of the 9,500,000 shares, I would imagine.
>
> THE COURT: You already owned those.
>
> THE WITNESS: But we didn't issue them to ourselves.
>
> THE COURT: Why pay for something you already owned?
>
> THE WITNESS: I can't tell you. I have experts that do this for me. I didn't do it.

With regard to the 2.5 million shares issued to each defendant on May 15, 2010, which was right before entering into the two Agreements with KNET on June 6, 2010, wherein KNET had the possibility of earning nearly 7.8 million shares for services rendered, in response to questioning as to whether the shares were issued to retain control over the company, Ruocco stated the following, "Call it whatever you like. KNET was never going to get more shares than myself and my sister" (Tr., p. 214).

Ruocco testified that on May 7, 2010, a Certificate of Amendment was once again filed with the Secretary of State which increased the number of authorized stock from 10 million shares to 25 million (*see* Pl. Ex. 14). Here, with the increase from 10 to 25 million, Ruocco admits to not owning any of those new shares (*see* Tr., p. 221). However, where the Certificate states that the increase was authorized "by a vote of a majority of all outstanding shares entitled to vote thereon at a meeting of shareholders," Ruocco acknowledged that no such vote was ever noticed or took place (*see* Tr., pp. 222-23).

The direct examination of Ruocco concluded by challenging his testimony with his own affidavit, dated September 17, 2013, wherein he swore that he paid for his sister's shares and gave them to her. He now disagreed with his affidavit and reiterated the claim that the funds came out of the accounts of each defendant (*see* Tr., pp. 224-5). Additionally, he believed that the company was certified as an IIP in Vermont in 2009 (*see* Tr., p. 225).

The defendant, Dennis Donnelly, was taken out of turn as a defendants' witness to accommodate his schedule. He is a shareholder and has performed accounting work for Interceptor. He introduced a one-page entry from the General Journal of October 31, 2006 showing a debit of $40,000 each from Ruocco and Sylvester (*see* Def. Ex. A), and a loans payable account for Sylvester, which did not list any repayments (*see* Def. Ex. C). He did disagree with his counsel when questioned as to whether the $40,000 listed on Pl. Ex. 16 was a withdrawal from Ruocco's loan account ("It's not a withdrawal, it's a journal entry") and he explained that the loans payable account for Ruocco shown on Def. Ex. B was a different account than that which showed the negative loan balance on Pl. Ex. 16 (*see* Tr., p. 231-2; 242).

Under cross-examination, defendant Donnelly explained that under Pl. Ex. 16, Ruocco had a net debit in his loan payment account as of the time of the claimed $40,000 transfer and that even as of the date of the print-out, September 19, 2013, this account still showed a negative balance to Ruocco (*see* Tr., p. 238-9; 243). Donnelly did not offer testimony that the transferred funds were utilized to purchase stock, just that funds were transferred.

Ruocco retook the stand on the next day of the hearing and, under questioning from his counsel, offered a certificate of directors action claimed to be from Safe Start and which purportedly shows that Ruocco owned all 200 hundred shares of the original company (*see* Def. Ex. E). The Court permitted its introduction but now rejects it as having no probative value. First, the document was never provided during the lengthy document discovery ordered by the Court, even though all such documents were demanded. Additionally, the document never mentions or references Safe Start and is completely blank as to important items. Moreover, it appears to the Court that the document was being used by counsel to impeach his own client's February 13, 2007 certificate (*see* Pl. Ex. 13). Additionally, under examination from KNET's counsel, confusing testimony was offered as to when the document was provided to counsel (*see* 2d Tr., pp. 49-51). The document's reference to a par value $.01 is counter to the no par value set forth in Pl. Ex. 10, Def. Ex. E, and Pl. Ex. 13 (*see* 2d Tr., pp. 54-60). Finally, even putting aside that it appears to have been filled out with different pens, upon examination of the document the Court finds that under the provision that resolves how the shares are to be issued, it only lists one share issued to Ruocco for consideration of ".01" (*see* Def. Ex. E). The subsequent section that purports to issue 200 shares is blank as to consideration, the obligation, the agreed value of services, the date of a promissory note, and other items. The Court rejects the belated submission offered on the last day of the hearing as simply lacking any evidentiary value.

Ruocco explained that Def. Ex. B represented monies he put into the corporation and that Def. Ex. C represents loans payable to Sylvester. He did admit that KNET did work to amend the laws in certain states to effect the inclusion of realtime data transmission but disagreed that it assisted in obtaining IIP certification in uncertified states (*see* 2d Tr., p. 17). As noted above, under the testimony of Melius, shares would be due and owing under paragraph 3(a)(iii) of the Business Development Agreement upon the company becoming certified as an IIP in at least one (1) state where the company is not yet certified. Although only eight states are listed under Schedule 1(a)(iii) of the Agreement, Ruocco believed that Vermont, although not listed as an excluded state, was certified late 2009 or early 2010 (*see* 2d Tr., p. 19). Contrary to the Grogan testimony, Rhode Island was an excluded state in the

Agreement. Ruocco did offer that Texas and Minnesota have also become IIP certified, but he claims after he terminated the Agreement with KNET (*see* 2d Tr., p. 23). The Court notes that the letter of termination was dated March 13, 2013, one week after the filing of the complaint in this matter (*see* Am. Comp., par. 54).

While contesting whether a Suffolk County law satisfied the requirement of the enactment or amendment of laws in at least one (1) state, Ruocco acknowledged that the shares were issued to KNET, "as a gesture of good faith..." (2d Tr., p. 22), and that KNET "got the law changed in Suffolk County and the company experienced some good growth, and we had to have money to build a product, otherwise we would have been put out of business" (2d Tr., p. 26; *see also* p. 36 ["I issued him shares"]). He agreed that he accepted subscription agreements for the issuance of stock but did not issue stock until after filing the Amendment Certificate (2d Tr., pp. 24-5). He still could not adequately answer the question as to how the transfer from the loan account to the capital account would leave him overdrawn ("I really don't know. I would have to talk to my accountant") (2d Tr., p. 35).

In discussing the share already issued to KNET, Ruocco had no real issue with the past issuances, just not to any additional shares (*see* 2d Tr., p. 39). Ruocco again testified that KNET never challenged the prior stock issuances before this litigation (*see* 2d Tr., p. 43). He did admit that the Business Development Agreement (*see* Pl. Ex. 1) and the Consulting Agreement (*see* Pl. Ex. 3), were reviewed by his attorney, Harold Paul (*see* 2d Tr., p. 46).

On redirect by KNET's attorney, Ruocco could not explain why he and his sister would pay a total of $80,000 for the original 200 shares that he already owned (*see* 2d Tr., pp. 60-1). When questioned about the June 30, 2013 Balance Sheet of Interceptor (*see* Pl. Ex. 17), Ruocco deferred to his accountant in trying to explain why it showed a negative balance in his shareholder loan account (*see* 2d Tr., pp. 65-8). But probably the most damaging testimony concerning the claimed purchase of the new shares from the defendants' respective loan accounts is the fact that at a purchase price of $.001 a share, the claimed transfer of $80,000 does not equate to 8 million shares, but actually 80 million shares (*see* 2d Tr., pp. 69-71). The Court rejects any after-the-fact claim of overpayment or entitlement to 80 million shares.

Returning to the Business Development Agreement, Ruocco could not explain why Vermont was not listed on Schedule 1(a)(iii), if Interceptor had previously been certified as an IIP in that state (*see* 2d Tr., pp. 73-75). He did agree Texas was certified as an IIP in 2012 (*see* 2d Tr., p. 76).

When questioned about the 2,803,214 shares issued pursuant to Section 3(a)(1) of the Business Development Agreement (*see* Pl. Ex. 1), Ruocco took exception to the claim in his Affidavit dated June 7, 2013 that KNET and Melius assisted in the adoption of Leandra's Law, but agreed KNET did assist with the realtime data transmission law and that KNET earned most of those shares (*see* 2d Tr., pp. 80-3). As to the Consulting Agreement, Ruocco could not recall if it was ever amended or that he ever signed an amendment (*see* 2d Tr., pp. 84-5).

At the conclusion of the hearing the Court expressed its concern and called for additional submissions on the issue of lack of corporate formalities when third-parties are asked to invest in a small single shareholder corporation and the obligations and duties owing to these new investors from the principal of the corporation (*see* 2d Tr., pp. 95-6). In fact, the record reflects that the day before Ruocco claimed to have purchased 4 million shares for the transfer of $40,000 from a negative balance loan account, an investor, Ghassan Marji, purchased just 25,000 shares for $50,000 (*see* Pl. Ex. 9).

The Court will start with the easiest request in plaintiffs' motion papers, that is, "correcting Interceptor's shareholder list to accurately reflect KNET's ownership interest, pursuant to Bus. Corp. L. §619, and entitling KNET to vote the corrected number of shares at shareholder meetings." Pursuant to the clear and unambiguous language of the June 6, 2010 Agreements, the Court finds that KNET is entitled to the following shares:

1) the 2,803,214 shares previously issued (*see* Pl. Ex. 2) pursuant to the Business Development Agreement, provision 3(a)(i), since throughout the hearing Ruocco had no real opposition to this December 20, 2010 issuance. An important law was passed in a state with KNET's assistance, satisfying that provision;

2) the 934,405 shares sought pursuant to provision 3(a)(ii) of the Business Development Agreement, were not earned since only the initial portion of that provision was accomplished but concededly not the remaining portion;

3) the 934,405 shares sought pursuant to provision 3(a)(iii) of the Business Development Agreement, were earned "upon the Company becoming certified as an IIP in at least one (1) state where the Company is not yet certified." Here, the record discloses that Vermont is not listed on Schedule 1(a)(iii) and Grogan testified as to his efforts, while he worked at Interceptor, to his efforts to have Vermont certified as an IIP after the date of the Agreement. In light of the listing as set forth on Schedule 1(a)(iii), the burden shifted to Ruocco to demonstrate that Vermont was previously certified and his claim of a mistake as to the states listed is insufficient. Additionally Texas was certified as an IIP state prior to the cancellation of the Agreement;

4) the 3,176,976 shares sought pursuant to provision 3(a)(i) of the Consulting Agreement, were earned since a 1.5 million dollar line of credit was obtained from the Flushing Federal Savings Bank, upon a loan guaranty signed by Melius, which financing Interceptor accepted and utilized. Since no proof was offered as to any amendment of this agreement, and, in fact, Ruocco insisted that no amendment was ever agreed to and that the shares that were issued (*see* Pl. Ex. 6, 382,158 shares, issued December 2, 2011; *see also* 218,390 shares, issued December 20, 2010 [item 71 shareholders list]) were partial payment for KNET's efforts at obtaining financing, KNET is entitled to an additional issuance of 2,576,428 shares, aside from the partial payment previously issued.

Therefore, KNET is entitled to an additional 934,405 shares pursuant to provision 3(a)(iii) of the Business Development Agreement, and an additional 2,576,428 shares pursuant to provision 3(a)(i) of the Consulting Agreement. Interceptor, by its de facto president, Ruocco, is directed to issue these additional shares in new certificates, within ten (10) days from the date of this Order. As set forth in this Court's August 27, 2013 Order, the Court did permit defendant Ruocco to remain as the de facto president of Interceptor until such time as the conflicting claims were resolved and he is directed to comply with this Order of the Court.

As to the remaining requests for relief in the underlying motion, based upon the motion papers, the post-hearing submissions and, most importantly, the testimony offered at the hearing, the Court finds that there is no question that Ruocco and Sylvester issued shares to themselves for inadequate consideration so that they could purport to own a majority of the company's shares and control Interceptor. As such, the Court grants partial summary judgment on the Eighth Cause of Action and compels the surrender of their shares in the company, aside from the 500,000 shares owned by Ruocco as reflected by the Certificate filed with the Secretary of State. As detailed above, the Court finds that

plaintiffs satisfied their burden of proof for the granting of partial summary judgment due to the misconduct engaged in by the defendants in the running of Interceptor and in their dealings with investors. The violation of this Court's prior order for the holding of a shareholders meeting and the holding of a secret meeting thereafter, is emblematic of the entire testimony presented at the hearing.

The Court rejects the claim by defendants that the filing with the Secretary of State on February 13, 2007 of the Certificate of Amendment (*see* Pl. Ex. 13), which was accomplished under the advise of an attorney, constitutes little more than a "typo." The document clearly stated that as of that date, only ten shares were issued by Interceptor, which would convert to 500,000 issued shares, with 9.5 million unissued shares still remaining with the company. Therefore, as of that date Ruocco could only claim to individually owing 500,000 shares. There was a complete failure of proof to overcome the filed document, which constitutes prima facie evidence of the facts contained therein (*see* BCL §106[a]). No certificate of correction has ever been filed (*see* BCL §105). The "SEC attorney" was never called as a witness to explain the convoluted machinations offered at the hearing to justify the issuance of 8 million shares to Ruocco and Sylvester.

Reference to a claimed October 31, 2006 transfer of funds from a loan account, four months before the filing of the Certificate of Amendment, as the basis for the issuance of millions of shares, years apart, is found by the Court to be simply not credible. No documentation was offered to support the purpose behind that transfer, other than Ruocco's testimony. As noted, no testimony was forthcoming from the SEC attorney, Mr. Paul. No explanation was offered as to why the 2010 shareholders list only listed 1.5 million shares for each defendant, if the transfer of funds was intended to purchase 8 million shares, as now claimed by Ruocco. After the February 13, 2007 Certificate of Amendment (*see* Pl. Ex. 13), no additional monies for stock purchases were forthcoming from the defendants, even though they are issued 5 million shares three years later. The constant changing of positions, as detailed above, coupled with the stunning breach of fiduciary responsibilities and duty owed to numerous shareholders, aside from KNET, and the utter disregard for corporate formalities, mandates the voiding of these shares purportedly owned by the defendants, except for 500,000 shares that are credited to Ruocco.

The Certificate of Amendment was filed just before the issuance of numerous shares of stock to third party investors, all for $2.00 a share of common stock. As detailed above, these investors purchased stock in 2005 and 2006 pursuant to Subscription Agreements (*see* Pl. Ex. 9). Affidavits attached to the motion papers are from investors who paid $2.00 a share.

The record demonstrates that defendants' shares were improperly issued and issued without sufficient consideration. Once Ruocco, by his signature on October 21, 2005, accepted the subscription agreement of Byron Gray, and accepted $50,000 for 25,000 shares (*see* Pl. Ex. 9), he could no longer treat Interceptor as his own personal property and thereafter issue to himself or his sister shares for either no or minimal consideration. Ruocco's only real defense to the challenge to his holdings and that of his sister, Sylvester, is that attached to the Business Development Agreement, as Schedule 4(a)(ii) was the current shareholder list, which was updated to May 2010 and which notes a total of 3 million in shares to the defendants, not the 8 million claimed to have been purchased. This claim was addressed earlier in this Order. The conduct of the plaintiffs herein does not justify the normal and reasonable conclusion that they, either by assent or acquiescence, accepted and adopted the breach of the normal fiduciary duty due and owing from a director. However, as noted above, Grogan signed and paid for a Subscription Agreement on August 6, 2006 (*see* Pl. Ex. 9A), months before the claimed transfer of funds from loan accounts for the purchase of stock. As such, he was immediately entitled to all the rights as a shareholder (*see* BCL §504[i]). Ruocco's wrongful conduct directly harmed Grogan,

irrespective of any claimed due diligence of KNET in entering into the two Agreements. Moreover, the claim of due diligence does not eradicate Ruocco's wrongful conduct and defendants offer no caselaw to support such a claim.

As a general rule, directors of a corporation cannot issue or dispose of the corporate stock to themselves for an inadequate consideration (*see* ***Hammer v Werner***, 239 AD 38, 265 NYS 172 [2d Dept 1933]). Directors "owe a fiduciary responsibility to the shareholders in general and to individual shareholders in particular to treat all shareholders fairly and evenly" (***Schwartz v Marien***, 37 NY2d 487, 491, 373 NYS2d 122 [1975]). So, a breach of fiduciary duty is established by proof that the directors failed to treat all stockholders fairly and evenly (*see* ***Aronson v Crane***, 145 AD2d 455, 535 NYS2d 417 [2d Dept 1988]). When issuing new stock, a director, such as Ruocco, must treat existing shareholders fairly (*see* ***Katzowitz v Sidler***, 24 NY2d 512, 518, 301 NYS2d 470 [1969]; *see also* ***Armentanto v Paraco Gas Corp.***, 90 AD3d 683, 935 NYS2d 304 [2d Dept 2011]). It is an inflexible rule that directors "cannot exercise the corporate powers for their private or personal advantage or gain" (***Pollitz v Wabash R.R. Co.***, 207 NY 113, 124 [1912]). As noted, a director breaches his obligation to shareholders when he obtains stock at an inadequate price. As held in ***Aronoff v Albanese***, 85 AD2d 3, 5, 446 NYS2d 368 (2d Dept 1982), "a clearly inadequate consideration invokes the same principles as the absence of consideration."

Ruocco is considered an interested director since he is receiving a direct financial benefit from the challenged transactions, that are different from the benefit received generally by all shareholders (*see generally,* ***Marx v Akers***, 88 NY2d 189, 644 NYS2d 121 [1996]). Where directors have an interest in the challenged action, the burden of proof shifts to the interested director to establish that the actions involved were reasonable and fair (*see* ***Alpert v 28 Williams St. Corp.***, 63 NY2d 557, 483 NYS2d 667 [1984]). His testimony failed to satisfy that standard. The contradictory and ever-changing testimony can not support the allocation of shares as set forth on the books and records of Interceptor.

In par. 3 of his September 17, 2013 affidavit before the Court, Ruocco explains that the two dollar stock price was established after consultation with corporate counsel and his accountant. "We believed it was fair based upon the technology that had been established and the progress of the company up to that point." As shown above, defendants issued shares to themselves for a fraction of this "fair" price. As explained in ***Katzowitz v Sidler***, 24 NY2d at 519, *supra*, when new shares are issued at prices far below fair value in such a corporation, existing shareholders "can have their equity interest in the corporation diluted to the vanishing point."

The actions detailed above are similar to the actions challenged in ***Siverio v Lavergne***, 1991 WL 220974 (SD NY), where shares issued to directors for an inadequate price was set aside as a breach of their fiduciary duty. Here, 5 million shares were issued in 2010 for no consideration and reliance cannot be made to the claimed October 31, 2006 transfer of funds to which no nexus is shown of an intended purchase of stock. In any event, the inadequate price is demonstrated by the sale of stock for two dollars a share, when defendants claim that on the very next day, they acquired shares for a pittance. Defendants' reliance upon BCL §504 is misplaced since such cannot shelter directors from responsibility for breaches of duty of care they owe as directors (*see* ***Katzowitz v Sidler***, 24 NY2d at 518-20, *supra*). As the Court of Appeals stated in ***Alpert v 28 Williams St. Corp.***, 63 NY2d at 568-69, *supra*, actions that may accord with the statutory requirements are still subject to limitation that they may not be for the undue advantage of the fiduciary at the expense of shareholders such as the plaintiffs.

Moreover, there was a failure of proof in this regard since defendants supported their claim entirely upon their purported purchase of stocks, which Ruocco claims to already own. In his post-

hearing memorandum, Ruocco repeatedly states that he already owned all the shares of stock and there was no need to transfer any money from a loan account (*see* Memorandum, p. 6). Ruocco goes so far as to contradict his hearing testimony and now claims, "In truth, he owns the authorized and unissued shares based upon the May, 2010 amendment to 25,000,000 shares" (*id.*). Such contradictory, conclusory, and unsubstantiated claims are insufficient to defeat summary judgment (*see generally,* ***Cuillo v Fairfield Prop. Servs. L.P.***, __AD3d__,2013 WL 6640868 [2d Dept 2013]).

No legitimate business purpose was offered supporting the issuance of stock to the defendants at the price claimed, nor was the claim made that the price they paid a fair one (*see* ***Armentanto v Paraco Gas Corp***., 90 AD3d 683, 935 NYS2d 304 [2d Dept 2011]; ***Katzowitz v Sidler***, 24 NY2d at 520, *supra*; ***Schwartz v Marien***, 37 NY2d at 492, *supra*).

Throughout this litigation, defendants have reluctantly, and at times, unwillingly responded to court orders for discovery or directions to conduct an uncomplicated shareholders meeting. This motion reveals the lack of fiduciary responsibility of Ruocco in the management of the affairs of the corporation, once shares were offered to investors and the plaintiffs. As held by the Court of Appeals in ***Dunlay v Avenue M Garage & Repair Co.***, 253 NY 274, 278-80, (1930),"[d]irectors may not authorize the issue of unissued stock to themselves for the primary purpose of converting them from minority to majority shareholders. Such conduct ... is inequitable in the highest degree."

Therefore, the Court grants the order to show cause brought by plaintiffs and voids all but 500,000 of the shares of Interceptor issued to Ruocco and all the shares of Interceptor issued to Ruocco's sister, Sylvester. The Court further enjoins said defendants from voting at the rescheduled shareholders meeting, except that Ruocco may vote his remaining 500,000 shares, and grants partial summary judgment on plaintiffs' Eighth Cause of Action, pursuant to CPLR 3212(e), based upon defendants' undisputed failure to provide sufficient consideration for their shares.

The Court declares that all of Sylvester's shares listed on stock certificates 17 and 62 are null and void and all of Ruocco's shares, originally listed under cancelled stock certificates 21 and 61 (reissued to his entity, Sea Breeze Technologies, LLC) are null and void, except for 500,000 shares that represent his holdings pursuant to the Certificate of Amendment and Interceptor is directed to cancel the challenged shares.

It is further ordered that defendants' counsel is directed to make all the appropriate arrangements, including notice to all shareholders, for the holding of a special meeting of shareholders of Interceptor, as modified by this short form order, within thirty (30) days of the date of this Order.

DATED: 12/24/13

THOMAS F. WHELAN, J.S.C.