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MEMORANDUM

SUPREME COURT : STATE OF NEW YORK
COUNTY OF NASSAU

PRESENT:
HON. IRA B. WARSHAWSKY,
Justice.

TRIAL/IAS PART 8

AUSTIN BOULEVARD RESTAURANT CORP., AUSTIN BOULEVARD PROPERTY CORP. and 650 ROUTE 112 RESTAURANT CORP.,

Plaintiffs,

Action No. 1

INDEX NO.: 003657/2004

-against-

LEONARD IACONO, MICHAEL IACONO, ROBERT D. MAYER, TSR ISLAND PARK CORP., TSR ISLAND PARK REALTY CORP, TSR FRANCHISING CORP. and MAYER & COMPANY,

Defendants.

TSR FRANCHISING CORP.,

Plaintiff,

Action No. 4

-against-

INDEX NO.: 016692/2008

BRIAN WARD and FRANK JACHETTA,

Defendants.

DECISION AFTER TRIAL

This is a story of two men, Brian Ward and Frank Jachetta, essentially inexperienced in the restaurant business, who purchased one franchise restaurant and then a second (Island Park) only

to watch them both dissolve into bankruptcy. The cause(s) of their disintegration is subject to debate. The market, poor management, fraud in the inducement (second franchise in Island Park), and whether the Franchise Act applies, are all possibilities and will be discussed herein.

Underlying the extreme factual sensitivity of the issues to be recounted will be whether the Franchise Act applies to our facts, the level of due diligence of Ward and Jachetta, the sufficiency of circumstantial evidence, and whether the burden of proof needed to prove fraud, clear and convincing, has been met by the plaintiffs Ward and Jachetta in Action No. 1.

The Port Jefferson Spare Rib Franchise

The Spare Rib ("TSR") is a small chain of casual dining restaurant on Long Island New York. At its height, in 2003, there were four TSRs on Long Island, Hicksville, Commack, Port Jefferson and Island Park.

The original restaurant had been opened in Commack by the father of Leonard and Michael Iacono and a partner. In the early 1990s Leonard and Michael Iacono became the owners of the Commack restaurant and later on opened another TSR in Hicksville.

The brothers determined that they might be able to franchise the TSR style of restaurants and formed TSR Franchising Corp. ("TSR Franchising") for the purpose of expanding The Spare Rib Brand.

The TSR and The Spare Rib name and logos were duly registered as trademarks belonging to TSR Management, Inc. ("TSR Management"), on December 19, 2000

TSR Franchising awarded its first franchise to G. & W. Restaurant Corp. ("G. & W."), operated by Frank Ryan, Sr. ("Ryan") for a restaurant to be built in Port Jefferson, New York (the "PJ Spare Rib") in or about 1999. G&W built the PJ Spare Rib, and operated as a The Spare Rib franchise.

In 2002, Leonard Iacono and Michael Iacono made a substantial investment to purchase and renovate the TSR IP Spare Rib, located in Island Park, New York. They purchased the real property, 4160 Austin Boulevard, Island Park, New York, in June 2002, at a cost of $775,000 and paid approximately $800,000 to substantially renovate the premises into a The Spare Rib restaurant. In late October 2002, TSR Island Park Corp. ("TSR IP" or "TSR Island Park") began operating the IP Spare Rib at the IP premises.

In September, 2002, Ward and Jachetta learned that The Port Jefferson Spare Rib was for sale by G&W. Shortly thereafter, they met with Ryan to discuss the purchase of the PJ Spare Rib. They entered into a letter of intent to purchase the restaurant and shortly thereafter, signed a term sheet with G&W, making a down payment. In approximately December 2002, Ward and Jachetta met with Leonard Iacono at TSR's corporate office located at the TSR in Commack, New York, for the purpose of becoming approved as franchisees for the Port Jefferson Spare Rib. They had not met with the Iaconos until after they had reached an agreement in principle with Ryan for the purchase of the PJ Spare Rib.

Who Are Ward and Jachetta?

Brian Ward ("Ward") is a 1990 graduate of Stony Brook University. While in school he worked thirty to thirty-five hours per week at a restaurant located in Southampton, New York. After graduation he worked at a series of jobs in the financial industry starting with a position at Dreyfus Corp, in 1992, with his final position being a Vice-President of Cohen & Steers Asset Management in December 2003. According to his testimony, he has worked in all facets of the financial sector including the auditing of financial statements. He worked as the Chief Operating Officer for a startup company known as Key Trade Online ("Key Trade"). While at Key Trade he was involved in due diligence in connection with the sale of said company. Within that context, he provided the purchaser with financial statements, audited financial statements, profit and loss statements, balance sheets and other requested financial information. Prior to purchasing the TSR Port Jefferson, he had never owned nor managed a restaurant.

Frank Jachetta ("Jachetta") is a co-owner along with Ward and an officer of Austin Boulevard Property Corp. (ABPC), Austin Boulevard Restaurant Corp. (ABRC), and 650 Route 112 Restaurant Corp. ("650").

Jachetta graduated from Hofstra University in 1988. For two years after graduation he ran his own computer consulting business followed by working for the Sbarro Corporation in database management. He was there for approximately 3 months. He then became employed by Multidyne, Inc., a communications equipment company doing circuit board layout and computer-aided design. In 1995 he purchased a two-family house in Sea Cliff, New York, part of which he rehabilitated for use as an investment property. It was sold in late 2000/early 2001.

Jachetta had become acquainted with Ward, having grown up with Ward's wife and brother-in-law. For a short period of time they were partners in a small importing business.

At that first meeting at the TSR office in Commack, Leonard Iacono told Ward and Jachetta that they "were the type of people he wanted to build his franchise on."

In late December 2002, Ward left his job at Cohen & Steers to undergo training at the Commack Spare Rib to become a Spare Rib franchisee. The training was six to ten hours a day, four to six days a week over a six-month period and included all aspects of the Spare Rib business, including front-end operations, back-end operations, the MICROS system, food ordering, "closeout" procedure, staffing and maintenance of necessary financial information.

MICROS is a point-of-service computer hardware and software system, licensed by MICROScan Corporation, which is used by numerous restaurants, including the Spare Rib restaurants, to track sales and receipts in a variety of ways and to create various sales reports.

Ward was trained that the MICROS system was the central nervous system of a Spare Rib restaurant and tracked every facet of The Spare Rib restaurant's operation, from the logging in and out of employees to the monitoring of inventory, labor hours, turnover of tables and the taking, entering and filling of customer orders by the staff.

Servers, managers and hostesses gain access to the MICROS system by swiping a card that looked like a typical credit card. In addition to the cards, owners could access the MICROS system from a personal computer in their own office area. On a daily and weekly basis, the MICROS system generated reports setting forth the net sales of the restaurant and the cash to credit card ratio of those sales, which enabled a Spare Rib owner to track sales. MICROS reports were used by TSRs accountants to prepare sales tax and income tax returns.

The "closeout" procedure at the TSR IP Spare Rib involved a manager collecting the cash, credit card receipts, gift certificates, etc. for the day and matching the restaurant sales against the end of the night sales report, more commonly known as a "Z" report that was generated through the MICROS terminal. As part of the closeout procedure, a manager would review the "Z" report, together with each server's individual server report, which reflected all of the sales made by the server during their shift and the cash collected by the server. The individual server reports were included in a closing package that the manager would "drop" into a safe in the management office

for later review by Leonard or Michael Iacono.

TSR's management level personnel, along with Ward, were trained to maintain their MICROS reports, to gather with the corresponding "Z" reports and individual server reports that were used by Spare Rib managers to close out the restaurant on a daily basis.

During the period of time between when Ward and Jachetta signed an agreement in principle to purchase the Port Jefferson Spare Rib and the time that a written purchase agreement was actually signed, Ward and Jachetta performed what might be called due diligence of the Port Jefferson Spare Rib by comparing costs to the MICROS reports in order to determine profitability, and by counting cash receipts at the restaurant for an individual business week. The apparent purpose of counting the cash was to verify the MICROS reports and sales figures by comparing actual, daily receipts and cash collected receipts against the daily MICROS reports. They would get a printout of a days MICROS sales report and then compare it with cash collected and credit card sales receipts.

Jachetta received a copy of the Franchise Agreement with TSR Franchising for the Port Jefferson Spare Rib. They also received a copy of the Franchise Agreement between G&W and TSR franchising, which Ryan had provided to them. Ward and Jachetta were represented by James Reynolds, a lawyer, in connection with the purchase agreement for the Port Jefferson Spare Rib. In signing the agreement they knowledged that they "conducted an independent investigation of the restaurant..." Plaintiff 650 Route 112 Restaurant Corp. ("650") closed on the purchase of the PJ Spare Rib on February 13, 2003.

At the closing, 650 entered into a franchise agreement (the "PJ franchise agreement") with TSR Franchising. This agreement was personally guaranteed by Ward and Jachetta. Beyond being assisted by their attorney, Mr. Reynolds, they also had the assistance of an accountant Thomas Pirro ("Pirro").

The Island Park Spare Rib Franchise

In late February or early March 2003, shortly after acquiring the PJ Spare Rib, Jachetta raised the issue with Michael Iacono of purchasing the Hicksville Spare Rib. Approximately one week later he met with Leonard Iacono in Commack. In December 2002, Leonard Iacono told Ward and Jachetta that they were "not ready" to open a second restaurant. Despite that, now, in

February 2003 Leonard Iacono said that while he was not interested in selling the Hicksville Spare Rib, the IP Spare Rib was "built to sell."

After this meeting a series of events occurred. Ward and Jachetta negotiated with Leonard Iacono for the purchase of the IP Spare Rib assets and premises and a letter of intent was executed, as of March 24, 2003 which provided for a total purchase price of $2,600,000. Of this amount, $1,350,000 was for the purchase of the IP premises, and $1,250,000 for the IP Spare Rib assets, with a down payment of $50,000 at contract. It also provided for various contingencies, including due diligence and plaintiff's ability to obtain mortgage financing. Frank Jachetta wrote a check for $50,000 to TSR Management.

The due diligence essentially began in late March 2003, from the time of the signing of a letter of intent (March 24, 2003) until closing (November 14, 2003); however, it was not conducted, in the opinion of the Court, with the same thoroughness as that done by Ward and Jachetta at the Port Jefferson Spare Rib. One might say that it was a different type of due diligence.

Thomas Pirro, the accountant who assisted Ward and Jachetta with their due diligence on the Port Jefferson Spare Rib also assisted with certain aspects of the Island Park transaction. He advised them, as part of due diligence, to be present at the Island Park location in order to observe customer flow, observe the activities of the staff and to work with the management team. Though they were present at the Island Park location on a variety of times, they never did spend an extended period of time at the location.

TSR, which is really Leonard and Michael Iacono, argue that the due diligence performed by Ward and Jachetta prior to their purchase of the IP Spare Rib, did not constitute the due diligence that a reasonable purchaser would have performed. This became one of the major issues at trial and one which the Court must rule on in order to reach a final conclusion in this matter. What did Ward and Jachetta do, vis-a-vis due diligence, prior to the purchase of the IP location and franchise?

As noted above they once again retained Thomas Pirro as their accountant.

What is the IP Spare Rib?

The TSR IP Spare Rib was a freestanding building that had recently been completely

refurbished as previously noted, by the Iaconos. It had seven different MICROS stations/terminals and was "very similar" to the Commack location. Each of these locations was accessible by Leonard Iacono, who was physically present at the Island Park location seven days a week for several hours at a time, for the purposes of entering information into the MICROS system.

There is no issue that Leonard Iacono was familiar with the IP Spare Rib MICROSystem, he was capable of using the system and had unfettered access to it. Furthermore, due to his control over the Commack TSR restaurant, he also had access to large amounts of cash. How he manipulated the cash flow from Commack will be discussed shortly, but he did have access to said cash flow.

When Ward and Jachetta met with the Iaconos in March 2003 to discuss their interest in purchasing the IP restaurant, they were told, by the Iaconos, that IP Spare Rib's sales were "very strong, in mid-to high 40s." In these early discussions about Ward and Jachetta purchasing the IP Spare Rib, Leonard Iacono indicated he was interested in selling the business and renting the real property to them. Jachetta disliked this idea and indicated that he wished to buy the property, not lease.

On March 14, 2003, Ward and Jachetta met with Leonard Iacono at his office in the Commack Spare Rib. It was at this meeting that Leonard Iacono provided them with a monthly revenue and expenses spreadsheet for the IP Spare Rib ("spreadsheet"). The spreadsheet reflected weekly revenue amounts starting at $45,000 and indicated monthly profits starting at $21,164 (Exhibit 8). It was also at this meeting of the discussion reached the point where Leonard Iacono was interested in now selling the property for $1.5 million and the restaurant for $1.325 million. Said offer was reflected in handwritten notes on the spreadsheet. Leonard Iacono affixed his signature and the date "4/14/03" to the spreadsheet indicated he was giving Ward and Jachetta until April 14, 2003 to make a decision on whether they wanted to move forward with the purchase.

On March 24, 2003, the parties once again met in the Commack office to sign a letter of intent for the purchase of IP business for the sum of $1,350,000 and the real property for the sum of $1,250,000. Two contingencies found within the letter of intent were that the purchasers had the opportunity to perform due diligence and that the IP Spare Rib was averaging $41,000 in sales

per week with an allowable variance of 10%. It was at this meeting, on March 24, 2003, that Jachetta provided Leonard Iacono the check payable to TSR Management. As far as Ward and Jachetta are concerned, this was a down payment on the purchase of the franchise. This is disputed by TSR, who contend that Ward and Jachetta never purchased or made any down payment for the purchase of the franchise.

At the March 24 meeting the purchasers were provided with a set of TSR IP MICROS sales reports for the period October 28, 2002, the date that the Iaconos opened the IP Spare Rib, to March 23, 2003.

Irwin Fein, the President of MICROScan, the Corporation that manufactures the MICROS system, testified at the trial. He referred to the system as "bulletproof" and that it ensures that all sales are "properly recorded" by restaurants wait staff. Obviously Mr. Fein has a certain pride in the product of his Corporation; however, he did appear to be quite credible during his testimony. He also testified to the method of deletion of records from the system which will be referred to later on in this decision.

The TSR IP MICROS reports, which contained Leonard Iacono's hand written notes, represented that from February 23, 2003 to March 23, 2003 the IP Spare Rib's average weekly sales were $39,110.

Four former TSR employees who worked either exclusively at the IP TSR or at both the IP TSR and one or another TSR restaurants testified during the trial. These were Marc Viggiano, Terry Wilson, Matt Barcia and Al Gaeth.

Marc Viggiano had been hired in November 2002 to be a manager at the TSR IP Spare Rib. Prior to being hired by TSR, he had prior experience in the restaurant business over a period of several years. He had become familiar with the MICROS system while managing an Uncle Jack's a restaurant located in Queens, New York. He had received on-site management training at the TSR IP Spare Rib from Claire Hansen and Al Gaeth, both longtime employees of the Iaconos. As a manager in training, he was responsible for customer service, sales, tracking sales, inventory and staffing.. He trained and worked at the TSR in Island Park for seven months from November 2002 to approximately June 15, 2003.

Leonard Iacono and Alan Gaeth said that Viggiano had only trained/worked as an assistant

manager for no more than two to three months. However, that was inconsistent with the business records of TSR, which reflected his service extending to June 15, 2003.

Despite the fact that the MICROS reports that were provided by Iacono to Ward and Jachetta reflected average sales per week in a sum of $39,110, Viggiano testified that the weekly sales "consistently ran in the low 30s."

It was during the same period of time that Leonard Iacono was telling his managers (Viggiano) at the IP Spare Rib that "we're not making no money here. We're putting money out of our own pockets to keep this place running." (e.g., Exhibit 101 at 22:8-24.)

It is from testimony such as this that Ward and Jachetta contend that the TSR IP MICROS reports provided by Leonard Iacono to them from February 23, 2003 to March 23, 2003 contained materially false and misleading information regarding the amount of cash sales being made by the TSR IP Spare Rib.

In late March 2003, Ward compiled a break even analysis for the IP Spare Rib. He based this on the amounts that have been set forth in the Spreadsheet and the TSR IP MICROS sales reports for the period of October 28, 2002 to March 23, 2003. He determined that the restaurant had to achieve weekly sales in excess of $33,000 in order to generate a profit. (Exhibit 30.)

In the spring of 2003, Jachetta visited the restaurant three times as a customer. Twice he came with his family and on another occasion he came with a friend and an acquaintance. On one occasion he spoke with Al Gaeth and on another he spoke with Marc Viggiano. During the visit when Jachetta spoke with the Viggiano, Leonard Iacono told Jachetta that the visits were "agitating the staff" and that "it probably would be better if we didn't go there so much." As a result, Jachetta testified that he did not return to the TSR IP Spare Rib as a customer.

This passing incident would have little meaning, but for the fact that the defendants (the Iaconos) contend that Ward and Jachetta failed to do the appropriate "due diligence" by not going to the restaurant more frequently and counting cash.

According to the TSR IP MICROS reports, in April 2003, the restaurant averaged $43,353.36 in weekly sales. They were not provided with the daily MICROS reports that would be the basis for the monthly reports.

Consistent with these reports, Leonard Iacono allegedly told Marc Viggiano in April 2003

that the prospective owners of the franchise "think this place is doing over $40,000,.... I'm telling these people I'm doing over $40,000." (See Exhibit 101 at 28:17-24). However, pursuant to the testimony of Marc Viggiano, though sales had initially been higher at the time the store opened, they had "leveled" off and "stayed pretty consistent" in the low $30,000 range. Thus, again, Ward and Jachetta argue that the TSR IP MICROS contained materially false and misleading information regarding the amount of cash sales being made by the TSR IP Spare Rib.

In late April or early May 2003, Jachetta met with Marc Viggiano at the Island Park restaurant. Viggiano stated that Leonard Iacono had encouraged him to go back and talk to Jachetta. Furthermore, that Iacono had told him to be very positive, to tell them things were going well, business was good and that was pretty much it. He testified that Leonard Iacono had never asked him to lie to Jachetta or Ward, but he acknowledged that he did lie to Jachetta about how the restaurant was performing. He stated, "I was instructed by my boss to make sure he walked away feeling good about it."

He further stated that Leonard Iacono told him "that we should talk about how good the sales were and how much he saw-but the volume was going to get better and the place was a great place. The customer base was real good. This was the perfect place to have this business, all that type of stuff."

On or about May 16, 2003, Ward, Jachetta and their accountant, Thomas Pirro, met with the Iaconos and their accountant, Robert Mayer, for approximately one hour at TSR's offices in Commack. Mayer had complete control and knowledge of the TSR entities. He also had a 5% profit interest in TSR Franchising, as determined by the profits reflected on TSR Franchising income tax returns. He prepared the income tax returns based on QuickBooks that were provided to him by TSR's bookkeeper, Christine Pagnelli. The revenue figures contained in the QuickBooks were based on the sales figures contained in the MICROS reports. Pagnelli prepared the sales tax returns for the TSR entities, including the Commack Spare Rib and the TSR IP Spare Rib.

At least one purpose of the May 16, 2003 meeting was for the Iaconos to provide Ward and Jachetta with the documents that Ward and Jachetta had previously requested in order to continue their due diligence. It was at this meeting that they were supplied with weekly TSR IP

MICROS reports for the period of March 24, 2003 to May 11, 2003. These reports reflected that the IP Spare Rib was averaging weekly sales in the sum of $44,296.36. Again, Viggiano had testified that the weekly sales were actually in the low 30's at this time, and again the plaintiffs argue that the reports contained materially false and misleading information regarding the actual amount of cash sales.

At the May 16 meeting, Leonard Iacono produced two profit and loss statements. One covered the period of time from December 30, 2002 to April 27, 2003. The second covered the period from March 31, 2003 to April 27, 2003. He handed these to his accountant, Mr. Mayer, who reviewed them, stated that "they are fine", and who then handed them to Ward. These P & L statements were consistent with the amount of sales as represented in the weekly TSR IP MICROS reports.

Immediately after meeting with the Iaconos and Mr. Mayer, Ward and Jachetta met with their accountant Mr. Pirro at a local diner. They reviewed the documents that have been presented to them including the Spreadsheet to verify the accuracy of the amounts reflected on the TSR IP MICROS reports. They questioned Pirro concerning the viability of the proposed purchase in light of the figures contained in the documents. On that same afternoon Pirro sent a facsimile to Robert Mayer requesting additional documentation for the IP Spare Rib, including a balance sheet, cash flow statement and information regarding various expense figures for labor, depreciation, taxes mortgage and interest. On May 19, 2003, Robert Mayer forwarded a response to Thomas Pirro.

In late May, 2003, through an introduction of Robert Mayer, Ward and Jachetta met with a representative of Commerce Bank (now TD Bank), Rabhir Amiri, regarding Austin's attempt to obtain financing for the purchase of the Island Park property. Also present at the meeting were two gentlemen from Vested Business Brokers, Ed Batier and Nathan Goldstein.

Mr. Amiri, discussed the requirements to obtain an SBA loan to purchase the Island Park property. He requested the TSR IP MICROS reports, the profit and loss statements, balance sheets, a business plan and miscellaneous other information.

To assist Ward and Jachetta in obtaining the loan, the Iaconos retained a consulting firm to prepare a "business plan" which would be submitted to the SBA to assist in obtaining loan approval. This "Business Plan" was not paid for by Ward and Jachetta, nor did they have

anything to do with approving the product, though they did have some input into it.

A portion of the business plan stated that:

> "The operators will generate ongoing revenue's and proven profits from the existing The Spare Rib locations in Port Jefferson and of the new location in Island Park. These two restaurants both have a substantial history. Categorically these restaurants generate average weekly sales of $40,000 – $60,000 weekly and bottom-line profits of $8 – $13,000 weekly." (See Exhibit 29, page 6.)

During a management meeting on or about June 15, 2003, Leonard Iacono and Viggiano had an argument wherein Leonard Iacono had allegedly said to Viggiano, "How the hell could there be 46 hours of overtime when the restaurant sales for the week were only $33,000." (Exhibit 101, at 99:15-100:16).

Testimony such as this, which reflects that income at the IP Spare Rib was dramatically less than the alleged $40,000 weekly, along with the "Business Plan" are in direct conflict with the TSR IP MICROS reports that Leonard Iacono was providing to Ward and Jachetta. For example, they indicated that during the Father's Day week, the IP Spare Rib generated weekly sales in the sum of $46,071.39. (Exhibit 1 at AUS10878).

Ward and Jachetta met with Mr. Amiri in the early part of July 2003. At this meeting they provided Mr. Amiri with the material that had been provided to them by either Leonard Iacono or Mr. Mayer (TSR accountant). This included the TSR IP MICROS reports, profit and loss statements and balance sheets that they had received to date, along with a copy of the "business plan". Mr. Amiri requested additional material which included updated TSR IP MICROS reports additional profit and loss statements, together with an explanation of any large expenditures might appear in the yet to be provided profit and loss statements.

These reports, which Mr. Amiri used for his due diligence with respect to financing for the IP real property purchase contained what today Ward and Jachetta contend were materially false statements. The Iaconos provided to the plaintiffs the TSR IP MICROS reports for September 2003, which continued to reflect average weekly sales in the $40,000 plus range, while at the same time Leonard Iacono was complaining to Terry Wilson in their weekly conversations, that the IP Spare Rib "was killing him, that he is losing his shirt over there, and it's just been a huge headache."

In response to Mr. Amiri's request for additional information, said request having been made at the July 2003 meeting, Robert Mayer, on September 17, 2003, faxed a letter to Leonard Iacono which contained a "list for the large expenses for the above referenced. [Of October 28, 2002 August 24, 2003]." (Exhibit 7). Iacono gave the letter to Ward, who forwarded it to Mr. Amiri.

On September 30, 2003, TSR IP Corp. and ABRC (Austin Boulevard Restaurant Corp.) entered into the Restaurant Purchase Agreement (RPA) for the sum of $575,000. According to the plaintiffs, this purchase price included the initial franchise fee of $50,000 payable to TSR Franchise pursuant to the IP Franchise Agreement. (Exhibit 18, paragraph 3). The Iaconos deny that any franchise fee was ever paid and that therefore the plaintiffs could not take advantage of the Franchise Act in pursuing any of their claims or defending any claims of the Iaconos as expressed in the counterclaims of action number one or the complaint in action number four.

The sale of the IP Spare Rib assets and real estate closed on November 14, 2003. At or before that date Austin Restaurant and Jachetta paid TSR Management $75,000 for the restaurant assets and gave TSR Island Park a purchase money mortgage note for the $500,000 balance of the purchase price. The note was secured by a mortgage against the premises. Apparently no payments were ever made on the note.

Also on September 30, TSR IP Realty Corp. and ABRC entered into the Purchase and Sale Agreement (Exhibit 20) by which TSR IP Realty Corp. agreed to sell the IP real property to ABRC for the sum of $1,525,000 (or $1,521,000.00 according to the defendants), to be paid with the proceeds of a Commerce Bank SBA loan ($1,143,750), a purchase money note, and a $200,000 deposit which was duly paid. (See Exhibit 73 at check number 1 in the sum of $125,000, check number 1806 in the sum of $25,000 and check number 172 in the sum of $50,000).

Between September 30, 2003 and November 13, 2003, Leonard Iacono continued to provide the purchasers with updated weekly TSR IP MICROS reports. (Exhibit 1 AUS10892-10898; trial transcript (TT), 971:2-22). These reports, when combined with previously provided reports represented the last seven weeks that the Iaconos owned the IP Spare Rib prior to its sale. During the seven week period, weekly sales averaged $40,612.08. The plaintiffs argue that these

reports that were provided to Ward and Jachetta for the period of September 30 to November 9, 2003, contained materially false and misleading information regarding the amount of cash sales being made by the TSR IP Spare Rib.

In a conversation between Leonard Iacono and Terry Wilson, who was to become the manager for the IP Spare Rib upon its sale, Iacono told Wilson that he needed to get the restaurant to $40,000 a week. He reinforced the sales goals that have been previously set during the period of time that the Iaconos had owned the restaurant since its opening.

During the same period of time Iacono was producing to Ward and Jachetta the MICROS reports that indicated that the IP Spare Rib was achieving weekly sales in the sum of $42,690.97.

On November 13, 2003, at 10:45 A.M., at the request of Leonard Iacono, a technician from MICROScan arrived at the TSR IP Spare Rib and performed the following work on their MICROS computer system:

> Cleared all totals from database
>
> Deleted all backups beyond recovery
>
> Erased "tape backup" beyond recovery
>
> Rebuild database (Exhibit 16; TT, 841:23-842:8)

Irwin Fein, the President of MICROScan, testified that in his twenty-seven years in the business, he had never seen a service report in which a technician used the phrase "beyond recovery" to describe the deletion of computer backups and tape backups. (TT, 1954:9-16; 1984:2-1986:1.) He further testified that "[a]lmost always the person that is taking over the restaurant will want all of the totals and all of the data that was currently in the unit at the time the other person owned it removed from the system." Note — it is the purchaser who wants to have the system cleaned out, not the seller.

On the evening of November 13, 2003, Ward and Jachetta performed inventory at the IP Spare Rib that lasted approximately three hours. Michael Iacono was present during the inventory and supervised it.

The closing took place the next day, on November 14, 2003. At the closing Austin plaintiffs paid additional closing costs, according to them, to purchase inventory and miscellaneous other items. The total out-of-pocket costs according to Ward and Jachetta, for the

purchase of both the business and the related property was the sum of $1,614,961.23. (see exhibits 73, 74 and 75; see also TT, 197:18-197:7; 205:18-210:14; 386:4 - 13)

At the closing TSR Franchising Corp. entered into a franchise agreement (The "IP Franchise Agreement" [Exhibit 19]) with plaintiff ABRC for the IP Spare Rib. Ward reviewed the IP Franchise Agreement before its execution. It is similar to the one that he entered into upon the purchase of the Port Jefferson franchise, but it is not identical.

The parties also entered into another agreement on the 14th of November. TSR Management entered into what is been purportedly called a Management Agreement. (Exhibit C). TSR Management, Inc. and TSR Franchising are separate companies with separate purposes. (TT, July 20, 2009, 18:16-22; 48:7-11). TSR Management, Inc. is not a party to Action One or Action Four.

Based upon all of the above, but most specifically the documentation, including the TSR IP MICROS reports, presented to Ward and Jachetta, as well as to their attorney and their accountant, the plaintiffs argue that they reasonably relied upon these representations regarding sales in purchasing the franchise. They further argue that they performed due diligence that a reasonably prudent purchaser in their position would have performed.

The defendants, the Iaconos, argue that the facts do not support the due diligence claim of the plaintiffs. They point out that Ward and Jachetta did not observe customer flow as part of due diligence, nor did they observe the activities of the Island Park staff as part of due diligence. They also contend that Ward and Jachetta did not work with the Island Park management as part of due diligence; furthermore that they did not "count cash" in order to verify the accuracy of the MICROS sales reports that they had been given (which they had done to some limited degree before their purchase of the Port Jefferson Spare Rib). And, finally, defendants argue that whatever due diligence Ward and Jachetta did perform, it was less than that which a reasonable purchaser would have performed.

The plaintiffs argue that the "due diligence" that the defendants contend was appropriate for the purchase of the restaurant, is irrelevant under the circumstances. They contend that the manner in which Leonard Iacono was inflating the sales reflected on the TSR IP MICROS reports and the fact that the TSR IP Spare Rib contained seven (7) different MICROS stations/terminals

that were always accessible by Leonard Iacono, even if Ward and Jachetta had spent several days and nights viewing the operation and counting cash at the TSR IP Spare Rib, they would not have uncovered the fraud being perpetrated by TSR.[1]

As noted above, on November 14, 2003, 650 and TSR Management Inc. entered into the purported Management Agreement. (Exhibit C). Jachetta complains on behalf of 650, that TSR Management, Inc. never performed any services under the management agreement. Leonard Iacono, on the other hand, contends that whenever they were asked to do something they did it. More specifically, the TSR Management Agreement, TSR Management was to perform "such management, marketing, franchise and sales support services... as may be mutually determined" by the parties.

In the Court's opinion, the Management Agreement was a sham. It was another conduit for providing funds to the Iaconos. The Court also finds that no services were ever provided pursuant to the Management Agreement. Furthermore, TSR Management, Inc. is not a party to either of the actions before the Court and therefore there can be no recovery on said agreement by TSR Management, nor by any other TSR party in either of these actions.

Under the IP Franchise Agreement, plaintiff, ABRC, agreed to pay a weekly continuing/franchise fee in the sum of $1,500 and weekly advertising fee in the sum of $1200. (See Exhibits 17, article 6, article 7, schedule B and schedule C). These weekly payments were to be made via "electronic funds transfer or other similar means." (Section 6.5 of the Franchise Agreement). In anticipation of the closing, the Iaconos set up a bank account at HSBC,

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[1] Q Mr. Ward, prior to the closing, did you and/or Frank Jachetta count cash at Island Park?
A No. We did not.
Q Why not?
A At the time we were very comfortable with all the documentation we have received, starting with the MICROS reports that we had gotten a lot of comfort with over the previous year. The profit and loss statements we received. The balance sheets. The fact that we had a meeting with Michael and Lenny's accountant at their office, and he reviewed the profit and loss statements, said everything looked good, and just, you know, the continual documentation received, the fact that Commerce Bank was comfortable lending us money to buy the business based on the documentation that we had received from Leonard and Michael Iacono.
Q Now, Mr. Ward, I think you mentioned - -
MR. MANDELUP: Objection, you Honor, move to strike the last part. It was hearsay about what Commerce Bank said.
THE COURT: Sustained.

denominated the "TSR account IP," to enable TSR to automatically deduct the weekly franchise fee and advertising fee due under the IP Franchise Agreement. The franchisee made deposits into the account. As part of the Island Park Spare Rib transactions, Ward and Jachetta each executed the "Personal Guarantee and Agreement to Be Bound Personally by the Terms and Conditions of the Franchise Agreement" (the "Personal Guarantee"). Within said guarantee each agreed to become "surety and guarantee for the payment of all amounts in the performance of the covenants terms and conditions of this agreement, to be paid, kept, and performed by" Austin restaurant.

More specifically, article 6.1 provides for the payment of a weekly "Continuing Fee"; 6.2 provides that the failure to pay the Continuing Fee be deemed a material breach of the agreement; and paragraph 7.2 provides that the franchisees contribute to a local advertising fund established by TSR. Article 8 of the Franchise Agreement provides for the production of books and records upon three days notice to the franchisees, and other articles provide more specifically what happens after termination of the franchisee.

Paragraph 25.3 of the agreement allows for the parties to agree upon the waiver of any specific obligation or restriction upon the other in the agreement. However paragraph 25.10 provides that there cannot be a modification, a change, rescission, or a waiver of the agreement unless it is made by a written agreement subscribed to by the officers of the franchisee and the president of the franchisor.

On November 14, 2003, Austin commenced the operation of the restaurant with the identical menu, food, food preparation, server staff, cooks, signage, advertising, Rib Rewards program and restaurant layout as had existed when the Iaconos owned the restaurant the day before. On the night of the closing, Ward went with the Iaconos to the IP Spare Rib. While there, he was once again provided with a daily MICROS report that reflected sales for the day of $6,632.65, a smaller number than what he was told the average Friday would produce. It was considered the second busiest day of the week behind Saturday. Even at this early date, the first day of ownership, Ward questioned Iacono about this lower amount and was told "don't worry, things will improve. You know, it's fine."

On November 15th and 16th, the sales of the IP Spare Rib remains substantially below the levels that had been reflected in the TSR IP MICROS reports. (Compare AUS02321-02322 with

Exhibit 1 and Exhibit 24). Terry Wilson reduced staff in these first few weeks and told a shocked Ward & Jachetta that they had to get sales up to "$40,000.00." (TT, 484:11-491:21 and Exhibit 59).

On November 19, 2003 Ward met with Leonard Iacono at the Commack Spare Rib in Iacono's office. Before Ward had a chance to even say anything Leonard Iacono said that he realized that the Spare Rib was having a "rough week." (TT, 117:21-118:10; 216:20-23). Ward testified that he told Iacono that he was concerned that the IP Spare Rib was on a pace to do weekly sales in the low 30s and was close to $8,000 to $9,000 off from the previous week's sales, when the Iaconos still owned the restaurant. In response, Leonard Iacono allegedly stated that he "will wave franchise fees for both the Port Jefferson and Island Park Spare Rib." (TT, 218:14-16). Besides denying any agreement to waive anything, the defendants point to the agreement which precludes a waiver without a writing.

Late in the evening on November 26, 2003, as part of what is considered Ward's ongoing effort to determine the reason for the lower-than-expected sales totals during the past two weeks, Ward conducted an investigation into the MICROS system at the IP Spare Rib using one of the MICROS terminals located in the restaurant along with his office computer. (TT, 246:13-17; 474:22-477:2; 478:23-482:3). Terry Wilson was present at the time.

The Smoking Gun

Ward and Terry Wilson discovered a series of five guest checks which the plaintiffs contend are bogus or fraudulent. These guest checks, consecutively numbered 1000 to 1005 have been entered into the system via a "forgot card" on November 13, 2003, at 2:57 P.M. and 2:58 P.M. (TT, 246:18-247:10; 258:18-259:3; 521:17-522:14; see also Exhibit 11). A "forgot card" is given to a server when he/she forgets his or her own personal card.

The bogus guest checks totaled $1013.94, including tax, were paid for in cash and indicated that six guests each were seated at five different tables and that each table ordered between twelve and fifteen entrées, including salmon, stuffed shrimp, steak, baby back ribs and barbecue chicken (and no beverage).

It is the plaintiff's theory that Leonard Iacono entered phony guest checks into the TSR IP MICROS system to systematically inflate the cash sales at the IP Spare Rib during the period that

Ward and Jachetta were conducting due diligence with respect to the contemplated purchase of the Island Park restaurant. It is the only direct evidence of such a theory, though it should be recalled that the MICROScan employee was at the restaurant in the morning (10:45 A.M.) and cleared all totals from database and deleted all backups "beyond recovery." Other evidence has been presented which the Court will review as support for that theory.

At one point, one or both of the Iaconos contended that this was a way of handling a private party, and that is why the guest checks were prepared in the fashion that they were prepared.[2] So that the Court does not have to revisit this, it should be clear that the Court rejects such a theory. Defendants argue that there was no logic to inflating the sales numbers the day before the closing and after the computer had been erased. Perhaps defendants' logic is correct, but then why aver, repeatedly, that the guest checks related to a private party? The Court also rejects a theory presented by the defendants that the plaintiffs, Ward and Jachetta in some fashion faked these guest checks to help them get out of a bad deal which they realized they entered into within one to two weeks of buying the franchise.

What allegedly did, or did not happen over the next twenty-four to forty-eight hours is of a telling nature.

Ward and Wilson discovered computer screens reflecting sales information from November 13, 2003 that incorporated the bogus guest checks, including screens entitled "Employee Time Card and Job Detail" (Exhibit 12), "Employee Sales and Tip Totals" (Exhibit 13), "Employee Closed – Guest Checks" (Exhibit 14) and "Daily System Sales Detail" (Exhibit 15). These screens identify each of the servers working at the IP Spare Rib on November 13, 2003, the net sales generated by the restaurant, the manner of sales, i.e. server, take-out, bar, "forgot card" sales detail, and the total cash and credit card sales for the day. (Exhibit 15).

In that each of the servers working out of the restaurant that day appeared to use their own

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[2]Matt Barcia is a former waiter at the TSR IP. He worked there from the time it opened in November 2002. He also worked at the IP Spare Rib after change in ownership. He also saw Leonard Iacono use the MICROS system a couple of times a week. He received "hands on" training with respect to the MICROS system used at the restaurant. (TT, 1106:16-1108:1). Barcia gave his view of the "bogus guest checks" which merges reality and computers: (1) The amount of food listed on the checks far exceeded what would be ordered by that number of guests at a lunch setting; (2) Despite the large amount of food, no beverages were ordered; (3) The manner of entry of the guest checks into the MICROS system did not reflect a pre-planned party; and (4) To top it off, many of the items listed on the checks were not offered on the TSR luncheon menu. (TT, 1146:5-1154:2).

cards, there would be no reason for them to be using a "forgot card", the entries had to have been made by a third-party, one with access to the computer system, and knowledgeable about its use.

Before leaving the restaurant that night Ward told Alan Gaeth, a longtime kitchen manager at the TSR IP Spare Rib, who had remained on the Iacono payroll but had stayed on at the IP Spare Rib after the sale, to assist Ward and Jachetta in the transition., that he, Ward, was "really alarmed [because] someone was playing with the numbers [that the] numbers were inflated, and [that] someone put in dummy sales." According to Ward, Gaeth turned red and "pretty shortly thereafter" left the restaurant. Gaeth does not deny this, and testified that Ward and Jachetta were "screaming," "ranting" and "enraged." (TT, 20272:13-20274:9).

On the morning of Thanksgiving, November 27, 2003, Ward received a phone call at his home from Michael Iacono, who stated "it wasn't what I [Ward] thought" and that the Iaconos "had $700,000 to work with this problem." Ward understood this to mean that the $700,000 referred to the $500,000 purchase money mortgage taken by the Iaconos with respect to ABRC's purchase of the IP real property and of the $200,000 referenced in the Management Agreement. The following morning, November 28, 2003, Jachetta received a phone call from Michael Iacono while he was sitting in his car in the driveway of his home. During the phone call Iacono told him "I don't know what you [Jachetta] think you got, but I have $700,000 to fix this problem." Michael Iacono denies this. Michael Iacono allegedly went on to state "we have to meet." On that same day, TSR automatically deducted the weekly advertising fee and a food purchase from the TSR account IP. This was the account exclusively set up so that the Iaconos could make automatic withdrawals for the purpose of fulfilling the agreements. (See Exhibit 40 at AUS10569).

There was no automatic deduction of the franchise fee from said account. Plaintiffs argue that this was consistent with Leonard Iacono's waiver of the franchise fee. (TT, 219:17-18; 224:14-24; see also Exhibit 40 at AUS10569, AUS10571).

On or about November 29, 2003, the Iacono brothers appeared unannounced at the Port Jefferson Spare Rib. They spoke for approximately twenty-five minutes. Ward testified that he told the Iaconos that something had gone on and he was very nervous about it. In response, Leonard Iacono allegedly said, "we are the Iaconos. We didn't do anything. We wouldn't do anything like that." Michael Iacono said, "Don't worry, we will help you pay your mortgage. We

will help you get through this."

In the first two weeks that the IP Spare Rib was under the ownership of Ward and Jachetta it averaged net sales in the sum of $28,701. (See Exhibit 58 at AUS02308-02323; Exhibit 102, p. 2).

According to the TSR IP MICROS reports (Exhibit 1) during the two-week period immediately prior to sale, the TSR IP Spare Rib averaged net sales in the sum of $40,883 (Exhibit 76, p. 2) a nearly $12,000 difference, which consisted almost entirely of reduced cash sales.

On or about December 3, 2003, at the request of the Iaconos, Ward and Jachetta met with them at the Hicksville Spare Rib. It had now been one week since the discovery of the Bogus Guest Checks. Jachetta handed the checks to Leonard. After reviewing them he stated "I thought you had something good. This is a pre-planned party" Michael Iacono stated similarly. Despite requests for proof of such "pre-planned party", none was ever produced.

During the meeting of December 3, Leonard Iacono allegedly offered to "take back" the IP store, but Michael said they "can't do that." (TT, 1622: 15-16). Plaintiffs also claim that Leonard agreed to waive payment of the advertising fee and to only charge for the food at cost. (TT, 298:3-8; 1626:4-12).

In the spirit of negative evidence, the statement covering November 29, 2003 to April 2004, there was no deduction for advertising from the IP account and food was deducted apparently at cost. (Exhibit 40); thus, supporting plaintiffs' argument that defendants had agreed to waive said fees. (There were two $1,200.00 deductions — one on November 28, 2003 and one on December 5, 2003.)

Testimony from Matt Garcia and Alan Gaeth, both defense witnesses, stated that the volume of business for several weeks before the sale of IP Spare Rib remained consistent with the initial several weeks after the sale. However, the average weekly net was $27,827.00 for the first seven seeks under the new ownership compared to $40, 612.00 for seven full weeks preceding. The decrease almost entirely attributable to a decrease in cash sales. This is clearly not a coincidence, nor due to a change in management.

In a meeting held toward the end of December 2003, to discuss menu changes, Leonard Iacono showed Ward and Jachetta a paper on Mad Cow Disease and stated that he believed it was

correlated to bad sales. (Apparently it was only affecting IP and not Commack or Hicksville. (See Exhibit 102.)

In a telephone call during the first week of January 2004, Leonard Iacono allegedly called Jachetta and stated he would take back the IP Spare Rib, but it was contingent on the Port Jefferson restaurant no longer being a Spare Rib, with removal of the signs. Jachetta stated this offer was unacceptable because 650 (the corporation that owned Port Jefferson) would forfeit the premium it paid to purchase a franchise restaurant.

Shortly thereafter, in January 2004, at Leonard Iacono's request, Ward met with Robert Mayer at his office in Deer Park. Mayer told Ward that the sales numbers that TSR had provided during the due diligence period were "correct". (TT, 313:10-17.) Ward questioned Mayer — How could he explain how the cash dropped so dramatically after they took over ownership? Neither Mayer nor the Iaconos responded.

From January 2, 2004 to March 31, 2004, the IP Spare Rib had average net sales of less than $28,000 per week (Exhibit 1 at AUS02190-02278; Exhibit 100, pp. 2-3) over $10,000 per week less than what had been presented by the TSR IP MICROS reports for a three-month period immediately preceding the sale. However, part of the pre-sale period was in late summer and early fall, while the post sale period was in obviously colder, more intemperate weather. The weather could account, in part, for such a decrease, but the statistics show a large portion of the drop was in cash sales. (See Exhibit 102, pp. 203).

The Lawsuit and Post-Lawsuit Activity

The first lawsuit commenced on March 17, 2004. On March 18, 2004, TSR provided "650", Austin Boulevard, Ward and Jachetta, with a notice of default. The default notice applied to the IP franchise as well as Port Jefferson. On April 23, 2004, TSR Franchising terminated the IP and Port Jefferson Franchise Agreements.

From that time until the actual closing of the restaurant (October 14th or 17th, 2004), the plaintiffs continued to operate the restaurants using the TSR (The Spare Rib) signage, trademarks and all related paraphernalia of The Spare Rib. It is this post-termination action by plaintiffs which forms the basis of the defendants' trademark infringement claims and claims of intentionally deceiving the public.

These acts by "650", Austin Restaurant, Ward and Jachetta created, in the opinion of the defendants, a likelihood of confusion to the public at large in the marketplace.

After Marc Viggiano provided an affidavit supporting Austin's fraud claim, he was approached by Daniel Guma, a former TSR employee. Guma allegedly told Viggiano, "What are you crazy. You're a good kid. You know, you've got some problems in your life. You don't need any more headaches from these people [the Iaconos] right now. Leave them alone." (Exhibit 100 at 38:15-40:2).

On June 9, 2004, the plaintiffs applied to the Court for a restraining order against the Iaconos. From March 2004 to September 2004 the parties, through their attorneys, continued to engage in settlement attempts. On October 17, 2004, this Court granted a restraining order against the Iaconos.

Bankruptcy

The "650" and Austin restaurant filed voluntary petitions under Chapter 11 of the United States Bankruptcy Code. During the course of the bankruptcy, pursuant to a Court order of July 8, 2005, the IP premises were sold to a third-party for the sum of $1,875,000. This was $350,000 more than the purchase price in the P.A. (See order of this Court dated February 26, 2008 in Actions 2 and 3).

Iacono's Tax Issues — Commack TSR

In June 2005, TSR retained Bernard Mark, Esq., a tax attorney, to review and address income and sales tax returns of the Commack TSR for the years 2002, 2003 and 2004, and to "make any appropriate corrections" to the returns. (TT, 1188:3-16-1195:3-8). What triggered this review is not exactly clear to the Court, but clearly it was connected to the then pending lawsuits, and not out of the Iaconos altruism.

The retention of Mr. Mark stemmed from Leonard Iacono's course of conduct, starting in 2000 and continuing through 2005, of not depositing in the bank all of the cash that was generated by the Commack Spare Rib. (TT, 693:12-697:18).

According to Leonard Iacono, from 2000 to 2005, he would arrive at the Commack Spare Rib in the morning, swipe his manager card through the MICROS system, hit a key on the

MICROS terminal which he referred to as the "Refund Button," and a key or keys corresponding to the amount of cash that he needed for that particular day.

Leonard Iacono would then put the amount of the "refunded" cash in his pocket and fill out a deposit slip for the Commack Spare Rib that did not include the "refunded" cash amount. (TT, 693:12-697:2).

Leonard Iacono testified that he learned how to use the Refund Button by "watching" the wait staff use the Commack MICROS system, but when questioned further, conceded that since the policy of the Commack Spare Rib was not to issue refunds, the wait staff never used the Refund Button. (TT, 701:3-703:16).

Moreover, according to Irwin Fein, the President of MICROScan, Refund Buttons are generally not employed by "full service" restaurants like The Spare Rib. (TT, 1988:22-1989:3).

Leonard Iacono's use of the Refund Button resulted in extensive cash sales not being reflected in the Commack Spare Rib MICROS reports. (TT, 691:1-9).

Leonard Iacono testified that he used the Refund Button to reduce Commack Spare Rib's cash sales by the sum of $3,500 per week in 2000 and 2001 and by the sum of $5,000 per week starting in 2002 and continuing in 2003 and 2004. (TT, 694:24-706:14).

Leonard Iacono further testified that when he used the Refund Button, the Commack MICROS system produced a "slip" reflecting his use of the Refund Button that he "threw ... in the garbage" every week. (TT, 711:1-10).

Leonard Iacono was obviously not concerned about keeping these records for tax purposes, nor had he ever asked his accountant, Mr. Mayer, what documentation he should be keeping for tax purposes.

Using simple math, one can clearly see that sales at Commack were understated for nearly five years from the years 2000 to 2004 by easily hundreds of thousands of dollars.

Leonard Iacono apparently never informed his bookkeeper, his accountant, Mr. Mayer, or even his brother, Michael Iacono, of his actions. Michael's lack of knowledge of his brother's acts is somewhat disingenuous since he was the recipient of some of Leonard's cash "Refunds" on an ongoing basis.

In June 2005, Mr. Mark's law firm retained the accounting firm of Present, Cohen,

Smallowitz & Glassman, LLP (the "Present Firm") to assist them in representing the Iaconos and TSR.

The Iaconos did not give Mr. Mark or the accountants any records to support Leonard Iacono's "Refund Button" transactions, but that is hardly surprising. The notes of Michael Cohen, of the Present Firm are somewhat more enlightening. They were made on or about June 30, 2005 when he met with Bernard Mayer, Esq., counsel for the defendants. They state, in part, "Omitted $950/Day," and contain two (2) columns entitled "original" and "changed." The "original" column depicts the omission of $950 per day, six days a week, for a total of $5,700. The "changed column depicts the omission of $950 per day, seven days a week, for a total of $6,650. Both columns contain the headings "Michael Iacono," "Lenny Iacono," "Casual and Other Labor" and "Store Expense." (Exhibit 95).

Under the "original" column, the omitted weekly cash amount of $5,700 is divided as follows: Michael – $1,500, Leonard – $1,500, Casual and Other Labor – $2,000, Store Expense – $700. Under the "changed" column, the omitted weekly cash amount of $6,650 is divided as follows: Michael – $1,750, Leonard – $1,750, Casual and Other Labor – $2,400, Store Expense – $750. (Exhibits 95). This was to reflect where the accountant said the cash went.

On September 13, 2005, the Present Firm prepared amended income tax returns for the Commack Spare Rib for the years 2002, 2003 and 2004 based on the amounts set forth in the "changed" column in Exhibit 95. (See Exhibits 48, 52, 56, 95).

Leonard Iacono reviewed and signed each of these returns. (TT, 686:12-14).

Prior to signing the amended income tax returns, the Iaconos met with Mr. Mark, who told the Iaconos that they "have to file an accurate return." (TT, 1198:7-13).

Nevertheless, and despite his firm recollection that he deducted $5,000 in cash every week in 2002, 2003 and 2004 using the Refund Button, Leonard Iacono signed amended income tax returns for 2002, 2003 and 2004 reflecting unreported cash sales by the Commack Spare Rib in the sum of $345,800, or $6,650 per week. (Exhibit 48, p. 1; Exhibit 52, p. 1; Exhibit 56, p. 1).

In addition, the amended income tax returns signed by Leonard Iacono contain a line item for "Casual Labor" expense in the sum of $124,800. (Exhibit 48 at Federal Statements, p. 2; Exhibit 52 at Federal Statements, p. 2; Exhibit 56 at Federal Statements, p. 2).

Based on the applicable IRS guidelines and the fact that the Commack Spare Rib did not issue any Form 1099's to any employees in 2002, 2003 or 2004 (TT, 1195:20-1196:19; 1585:10-17), the $124,800 expense for "Casual Labor" reflected that in 2002, 2003 and 2004, the Commack Spare Rib had 208 employees on a cash payroll. (TT, 1584:13-1586:23).

The data for "Casual Labor" contained in the Commack Spare Rib's amended income tax returns stood in stark contrast to the testimony of Leonard Iacono, who vehemently denied that he ever paid a single employee of the Commack Spare Rib in cash. (TT, 725:19-22; 741:4-6). He did pay employees of another of his companies in cash.

According to Leonard Iacono, his practice of paying employees "off-the-books" was limited to the employees of Express Unlimited, the company that he formed to provide commissary services to the Spare Rib Franchise. (TT, 689:14-17; 697:15-697:24; 725:8-734:6; 738:12-740:11).

The Present Firm prepared amended tax returns of 2000 and 2001 in December of 2006 for the Commack TSR (while Leonard Iacono was being deposed in this matter). Leonard Iacono denied ever seeing the language on the tax returns, "Under penalty of perjury, I declare that I have examined this return, including accompanying schedules and statements, and to the best of my knowledge and belief it is true, correct and complete." (TT, 767:22-769:3).

In the opinion of the Court, Leonard Iacono is incredible. The amended tax returns filed on his behalf are as incorrect and fraudulent as the original returns. The "Casual Labor" figure was a creation of his accountants, with or without his aid, and has no basis in fact.

In that the accountants had added such large amounts to the returns, they looked for a creative way to reduce these now larger numbers using "Casual Labor" and "Store Expense" deductions. The recasting of the TSR Commack's tax returns has raised creative accounting to a new level.

Whether Leonard Iacono now denies the truthfulness of the amended returns or prefers to say he paid the employees of another corporation in cash, is irrelevant to the Court. It still considers him incredible.

Analysis Prepared by Ward

The plaintiffs, but more specifically Brian Ward, performed an analysis of the sales of the

TSRs and produced interesting findings which the plaintiffs contend support their fraud theory, or, more specifically, that the MICROS reports given to the plaintiffs were fraudulent.

Prior to the due diligence period, the ratio of cash to credit card sales at the Spare Rib restaurants was as follows: (a) Hicksville – 57% to 43%; (b) Commack – 51% to 49%; (c) TSR IP – 59% to 41%. (Exhibits 102, 103, 104, 105, 107; TT, 211:53-217:13; 1393:12-1396:22; 1408:1-2; 1412:12-1419:15).

During the due diligence period, the cash to credit card ratios at the Spare Rib restaurants were as follows: (a) Hicksville – 56% to 44%; (b) Commack – 47% to 53%; (c) TSR IP – 64% to 36%. (Id.).

Following the sale of the IP Spare Rib, the cash to credit card ratios at the Spare Rib restaurants were as follows: (a) Hicksville – 53% to 47%; (b) Commack – 46% to 54%; (c) IP – 54% to 46%. (*Id.*).

During the pre-due diligence period, the average sales per tipped hour at the TSR IP Spare Rib was $77.71. During due diligence period, the average sales per tipped hour jumped to $102.67. (Exhibit 79).

During the pre-due diligence period, the average sales per tipped hour at the Commack Spare Rib was $96.85. During due diligence period, the average sales per tipped hour decreased to $85.44. (Exhibit 79).

During the pre-due diligence period, the average sales per tipped hour at the Hicksville Spare Rib was $93.96. During due diligence period, the average sales per tipped hour remained constant at $93.02. (Exhibit 79).

According to the MICROS reports, in 2003, the percentage of food purchases to sales at the Hicksville Spare Rib was 38%. (Exhibit AU).

According to the MICROS reports, in 2003, the percentage of food purchases to sales at the TSR IP Spare Rib was 35%. (Exhibit AU).

When the sum of $6,650 per week (weekly adjustment on amended tax returns for Commack) is deducted from the sales by the TSR Spare Rib for the period of February 23, 2003

to November 13, 2003, the food to sales ratio becomes 39.8%. (Ct. Exhibit III).[3]

When the sum of $6,650 per week is added to the sales by the Commack Spare Rib during 2003, the food to sales ratio becomes 39.8%. (Ct. Exhibit III).

According to the MICROS reports, in 2003, the percentage of payroll expense to sales at the Hicksville Spare Rib was 24%. (Exhibit AU).

When the sum of $6,650 per week is deducted from the sales by the TSR Spare Rib for the period of February 23, 2003 to November 13, 2003, the payroll expense to sales ratio becomes 26.33%. (Ct. Exhibit III).

When the sum of $6,650 per week is added to the sales by the Commack Spare Rib for 2003, the payroll expense to sales ratio becomes 22.9%. (Ct. Exhibit III).

During the due diligence period, the TSR IP Spare Rib averaged $42,480.32 in weekly sales, which represented a less than 5% decrease from the period of December 1, 2002 to February 16, 2003. (Exhibit 106).

During the due diligence period, the purchases by the TSR IP Spare Rib of potatoes decreased by 25.21%, the purchases of onions decreased by 25.43%, the purchases of mushroom decreased by 13.16% and the purchases of tomatoes decreased by 10.19%, as compared to its purchases during the period of December 1, 2002 to February 16, 2003. (Exhibit 106). However, the purchase of other produce – romaine and iceberg lettuce – went up as did lemons (but only slightly).

During the due diligence period, the purchases by the TSR IP Spare Rib of Pepsi decreased by 25.66% as compared to its purchases during the period of December 1, 2002 to February 16, 2003. (Exhibit 87).

The goal of plaintiff, Austin, is to show that the defendants had fraudulently inflated sales at IP Spare Rib. As indicia of that, while for the most part beverage and raw food product purchases decreased during the due diligence period by nearly 25%, the net sales barely changed (5% decrease). Thus, they argue, it is "other" evidence of fraudulently inflated sales.

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[3]Court Exhibit III was created on a white board in the courtroom during the cross-examination of Mr. Giambalvo, defendants' expert witness, and to some extent during the re-direct of said witness. It reflects the plaintiffs' theory of the movement of money from the Commack TSR to the Island Park TSR to inflate Island Park's sales figures.

Status of the Parties' Claims

By Short Form Order dated January 16, 2009 (the "January 16 Order"), the Court granted summary judgment to TSR Franchising against Ward and Jachetta on the issue of liability on TSR Franchising's claims in Action No. 4, and dismissed the Austin Parties' claims against the TSR parties in Action No. 1, all with respect to the Port Jefferson Spare Rib. Following the close of the Austin Parties' case at trial, the Court dismissed the Austin Parties' Tenth Cause of Action for tortious interference with contractual relations, finding that Austin had provided "insufficient proof down the line, no matter what the burden is." (Trial Tr. 1838:7-10).

In addition, following the trial, the Court dismissed the Austin Parties' First and Eighth Causes of Action, both common law fraud claims, finding that the waiver provision contained in the Island Park Franchise Agreement was specific, not general. (Tr. 2404:3-25).

Therefore, the Austin Parties' only surviving claims in Action No. 1 (also adopted as counterclaims in Action No. 4) are the Fourth and Fifth Causes of Action for fraud under the New York Franchise Act (the "Franchise Act"), General Business Law ("GBL") §§ 687 and 691.

Also in the January 16th Order, with respect to the TSR Parties' counterclaims and affirmative defenses in Action No. 1 and claims in Action No. 4 related to the Island Park Spare Rib, the Court determined that the issues of material fact to be tried were limited to "whether or not the [TSR Parties] manipulated the financial records of the Island Park Spare Rib during the period when [the Austin Parties] were performing their 'due diligence' inquiry," and "whether or not the [Austin Parties] exercised adequate due diligence, and if they did not, whether more rigorous inquiry would have revealed the bookkeeping irregularities which they allege." (January 16th Order at 9).

Therefore, based on the January 16th Order, if Austin failed in its burden to prove at trial, by clear and convincing evidence, that the MICROS reports and financial statements they were given during the due diligence period were fraudulent, or that their due diligence was adequate, and that if they did not perform adequate due diligence, that a more rigorous investigation would not have discovered the alleged fraud, the TSR Parties must prevail. The Austin Parties must prove, by clear and convincing evidence, each element of their fraud-based claims, most notably, that they reasonably relied on the financial information they were given.

Does the New York Franchise Act Apply?

It is clear that under our facts if the Franchise Act does not apply, plaintiffs remaining claims must be dismissed. General Business Law § 681(3)(a) defines a franchise as one required to pay a fee; and the defense argues that because Austin Restaurant (the alleged franchisee) never paid franchise fees for the Island Park Spare Rib (TT, 598:15-599:1), the act does not apply and the claims must be dismissed.

The Real Estate Purchase Agreement ("RPA") (Exhibit 18) states in paragraph 3 that the purchase price for Island Park real estate is $575,000 and that the sum includes "the initial franchise fee of $50,000.00 payable to TSR Franchising pursuant to the Franchise Agreement." Defendants do not deny the clear language of the document, but argue that only a $50,000 initial deposit was paid prior to the start of the litigation relating to this transaction (Franchise Litigation), therefore, Austin Restaurant is not a "Franchise" under the Franchise Act and has no standing to proceed under the Act.

This is an interesting argument in that TSR has based its claims against Austin on the breach of said Franchise Agreement which, they now contend, plaintiffs have no standing to sue under.

Further, in the weeks which ran into months, following the November 14, 2003 closing, TSR withdrew advertising fees (until they were allegedly waived) and food fees from the aforementioned TSR IP account on a regular weekly basis. It did not withdraw new franchise fees (which Austin claims were waived). TSR has offered no explanation of why they would be withdrawing fees from an account representing a franchisee if they were not a franchise.

Defendants' contention that there could be no waiver of the fees without a writing is not relevant to the point of whether Austin was or was not a franchisee.

TSR seeks the benefits of performing as a franchisor while depriving Austin those benefits provided it by statute as a franchisee. The Court rejects TSR's claim that Austin was not a franchisee and finds Austin is entitled to proceed in Action No. 1 under the benefits provided by the Franchise Act and defend itself, where appropriate, protected by the Act.

Proof of Fraud

Adapting the charge on fraud from the PJI, the fraud instructions, and the burden of proof

would follow as indicated:

> The plaintiff Austin Parties seeks to recover damages that they claim were caused by a fraud committed by the defendant TSR Parties. In order to recover for fraud, the Austin Parties must prove by clear and convincing evidence that the TSR Parties made a representation of fact; in our case that would be the weekly MICROS reports, the profit and loss statements and the balance sheets; that the representation(s) were false; that the TSR Parties knew that the representation(s) were false or made the representation recklessly without regard for whether it was true or false; that the TSR Parties made the representation to induce the Austin Parties to rely on it; and that the Austin Parties did justifiably rely upon it, and sustained damages.
>
> The burden is on the plaintiff to prove fraud, by clear and convincing evidence. This means evidence that satisfies you that there is a high degree of probability that there was fraud, as I have defined it for you.
>
> To decide for the plaintiff it is not enough to find the preponderance of evidence is in the plaintiffs' favor. A party who has proved his or her case by a preponderance of the evidence only need to satisfy you that the evidence supporting his case nearly represents what actually happened in the evidence which opposes, which is opposed to it. The party who establishes his case by clear convincing evidence must satisfy you that the evidence makes it highly probable that what he claims is what actually happened.
>
> If, upon all the evidence, you are satisfied that there is a high probability that there was fraud, as I have defined for you, you must decide for the plaintiff. If you are not satisfied that there is such a high probability, you must decide for the defendant.

"The elements of fraud are narrowly defined, requiring proof by clear and convincing evidence. Not every misrepresentation or omission rises to the level of fraud." *Gaidon v. Guardian Life Ins. Co. of Am.*, 94 N.Y.2d 330, 350 (1999) (emphasis added) (internal citations omitted). "In an action to recover damages for fraud, the plaintiff must prove a misrepresentation or a material omission of fact which was false and known to be false by defendant, made for the purpose of inducing the other party to rely upon it, justifiable reliance of the other party on the misrepresentation or material omission, and injury." *Lama Holding Co. v. Smith Barney, Inc.*, 88 N.Y.2d 413, 421 (1996). See also, *New York Univ. v. Continental Ins. Co.*, 87 N.Y.2d 308, 318 (1995); *Channel Master Corp. v. Aluminum Ltd. Sales*, 4 N.Y.2d 403 (1958). In the instant case,

the plaintiffs' rely on circumstantial evidence[4] to prove said fraud.

Due Diligence and Justifiable Reliance

Defendants contend that plaintiffs have failed to offer any evidence on the sufficiency of the "due diligence" conducted by plaintiffs, and, thus, cannot contend that they justifiably relied on the defendants' presentation during the due diligence period. "Where a party has the means to discover the true nature of the transaction by the exercise of ordinary intelligence and fails to make use of those means, he cannot claim such reasonable reliance on defendant's misrepresentations ..." *Stuart Silver Assocs., Inc. v. Baco Dev. Corp.*, 245 A.D.2d 96, 98-99 (1st Dept. 1997). "[A] fraud claim will not survive where the alleged fraud was discoverable through due diligence." *Danann Realty Corp. v. Harris*, 5 N.Y.2d 317, 322 (1959).

Barry Berg, Austin's expert, was not examined on the issue of due diligence by plaintiff.

Robert Giambalvo (TSR's expert) testified at length on what due diligence should have been done for the purchase of a restaurant of this size. It was all quite interesting and detailed. He agreed that if you owned a restaurant as part of a chain and you were buying an additional one, it might be less, but since the first purchase was from a different party (not Iacono), then the duties of the prospective purchaser would not differ greatly from the first purchase to the second (ignoring the fact that all details of the operation of the Port Jefferson TSR were identical to the Island Park TSR).

After being given a lengthy hypothetical (TT, 2186-2194) and being asked to assume the sales in the MICROS reports were inflated, he opined about what would have had to have been done to catch the over inflation of sales figures (the hypothetical contained eighteen factors).

First, he commented that there was no opportunity to do what was alleged to have been done by the defendants. "If you [prospective purchasers] are there all day long there is no opportunity to do what's been alleged here. . . . You would be able to see consolidated daily MICROS which would be for a full day." (TT, 2192). Most specifically, he was addressing the

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[4]PJI 1:70 (excerpts): "Direct evidence is evidence of what a witness saw, heard or did, which, if believed, ... proves a fact. . . . Circumstantial evidence is evidence of a fact which does not directly prove a fact in dispute but which permits a reasonable inference or conclusion that the fact exists. . . . Those facts which form the basis of an inference must be proved and the inference to be drawn must be one that may be reasonably drawn. . . . [T]he circumstantial evidence, if accepted, . . . allows [the fact-finder] to conclude that the fact in dispute has been proved."

padding of daily sales at Island Park.

On three or four occasions before Ward and Jachetta purchased Port Jefferson, they arrived at the restaurant shortly before closing then counted cash and credit card receipts to compare to the MICROS reports. (Ward TT, 1649:2-1650:2). They did not do this type of due diligence for Island Park.

Defendants argue that the plaintiffs would have discovered the alleged fraud (if it had taken place) if they had done their due diligence. Thus, the defendants contend, they would have caught the over inflated MICROS reports and, therefore, Giambalvo concluded they did not act with due diligence.

Mr. Giambalvo significantly based his opinion on the failure of the plaintiffs to do a variety of things:

1. Count heads — to confirm/reconcile the information you have been given by the seller with what you see.

2. Talk to employees (and the restriction from talking with employees would be a red flag).

3. Get books and records of the business.

4. Compare MICROS for days you were there with days when you were not there. Obtain split MICROS from the mid-day and evening reports, then to a daily report. This would, in Giambalvo's opinion, enable you to determine if a fraud had taken place. (TT, 2192-2193).

Most specifically, he testified, if $6,650.00 was added to the Island Park's weekly totals, which would be equivalent to perhaps 66 people per week, you would be able to see that increase (assumes $100.00 per person). Originally, Mr. Giambalvo estimated 600 more people per week would be needed to account for the $6,650.00 of inflated income, but revised that to 66. He still insisted that was a quantity of people that would be easily noticed. He noted that if the parties conducted a gross profit analysis, and a cost of labor analysis, it would allow you to "determine some of these things." (TT, 2180:16-2194:12). It is clear to the Court that sixty-six people spread out over a seven day week would not be noticed by even the keenest observer. It also diminishes an expert's credibility, that when caught in an obvious mistake, he adheres to his mistaken opinion/position. (The $6,650.00 is the amount of cash Leonard Iacono was skimming from the

Commack TSR in 2003 — 2004.

What stands out, as argued by the plaintiffs, is what Giambalvo failed to consider in evaluating the "due diligence" of Ward and Jachetta, specifically, (a) Ward's experience in dealing with financial documents (exemplified by his presentation at trial); (b) the nature of the existing business and personal relationship between the parties (pre-existing franchisor-franchisee relationship; franchisor tells franchisee/prospective franchisee not to talk to people at Island Park location); (c) that Leonard Iacono provided Ward and Jachetta with the "spreadsheet"; (d) Ward's experience with operating the Port Jefferson TSR (though not extensive he does not come to the table as a complete novice); (e) that the TSR Island Park MICROS given to Ward and Jachetta were the ones used to file TSR Island Park's income and sales tax returns [and thus the purchasers had the right to assume they were accurate]; (f) the meeting and exchange of documents amongst Ward and Jachetta and TSR's accountant (who also had a small profit interest in the franchising company); (g) frequent telephone contact between Ward and Austin's accountant tracking "recent developments and results of their "due diligence" efforts; and (h) Ward's visits to TSR Island Park to observe the activities at the restaurant.

Every party has the right to shape its own hypothetical and it is obviously up to their expert to respond accordingly. Mr. Giambalvo's opinion failed to consider the above factors, and, in the opinion of the Court, reduces the weight this Court chooses to give said opinion and eventually to reject it.

The argument of the defense becomes even more interesting when they point to three elements of plaintiffs' case which plaintiffs contend are indicia of the inflating of business volume and, thus, circumstantial evidence of fraud.

The testimony of Matthew Barcia about, among other things, how business was slow at lunch "we were never really filled at lunch." (TT, 1109:21-22).

The testimony of Viggiano discussed, among other things, that entire sections of Island Park's Spare Rib were closed during peak dinner hours on some nights during the due diligence period. (Viggiano TT, 21:6-15).

Furthermore, that Jachetta contended that Leonard Iacono told him not to visit the Island Park TSR because it would upset the staff/help.

Thus, the defendants contend that if we assume the above to be true, if Ward and Jachetta had done their due diligence, they would have discovered the above. That is truly speculative in that it was clearly Leonard Iacono's goal to limit contact between the purchasers and his employees, and also orchestrate, if possible, what his employees would say to the prospective purchasers.

However, the heaviest weight would be given to the allegedly inflated MICROS reports. The defense argues that even the Port Jefferson due diligence (counting cash and credit at the end of day and comparing to MICROS reports) would have caught the alleged inflated reports. This would have precluded the "reasonable/justifiable reliance" argument of plaintiffs.

How far must a buyer go in conducting "due diligence"? Must our buyer be equivalent to a forensic accountant? Were Ward and Jachetta confronted with some obvious false information which they failed to investigate or follow up? Should they have been "on guard" of some skullduggery which they proceeded to ignore, only to now claim they were blindly led to the slaughter?

In *Mallis v. Bankers Trust Co.*, 615 F.2d 68, 80-81 (2d Cir. 1980), the court takes into account the degree to which the truth was accessible to the defrauded person or parties. A heightened degree of diligence is required where the victim of the fraud had hints of its falsity.

It would appear to the Court that all the information conveyed to the plaintiffs during the due diligence period, both voluntarily and pursuant to their request and the request of their accountant, would not have waived the red flag, be it Jachetta's conversations with Marc Viggiano, the information contained in the Island Park balance sheets, cash flow statements, P and L statements, the conversations between the accountants, the spreadsheet (Exhibit 8), or the business plan (Exhibit 29), would indicate that the restaurant was not generating the sales reflected in the MICROS reports as found in Exhibit 1.

The facts of this case are not those of the sale of the mom and pop business where the seller says we make $40,000.00 a month and the buyer relies on that without more. Layers of complex due diligence were conducted here and the sellers were persuasive in convincing the buyers to not make frequent visits to the Island Park TSR.

The sales data information relied upon by the prospective buyers would appear to be that

relied upon by the defendants' own bookkeeper and accountant in preparing income and sales tax returns. One would think that what was good enough for TSR's tax compliance should be good enough for the purchaser's of the franchise. Of course, Ward and Jachetta were unaware of Leonard Iacono's use of the "refund button" at the Commack TSR, when they were contemplating their purchase.

In determining whether a buyer "justifiably" relied on information given to it, each case must be examined on its specific facts. See, *Stutman v. Chemical Bank*, 95 N.Y.2d 24 (2000) ("justifiable reliance on a fraudulent misrepresentation is shown if 'a reasonable man would attach importance to its existence or non-existence in determining his choice of action in the transaction in question.'"

To sum it up, the Iaconos are "hoisted by their own petard."[5] They argue that because plaintiffs did not "count cash" before purchasing IP Spare Rib, they did not use due diligence and, therefore, if there was fraud, it does not matter because the plaintiffs did not perform "due diligence" that would have caught the alleged fraud if it existed. This argument is dizzying and convoluted. First, there is no evidence whatsoever that counting cash would have caught bogus guest checks on any particular day, nor does it take into consideration that the Franchise Act's purpose is "to protect the would-be franchisee from fraudulent and unethical practices." *AJ Temple Marble & Tile, Inc. v. Union Carbide Marble Care, Inc.*, 162 Misc.2d 941, 947 (Sup. Ct., N.Y. County, 1994), aff'd. 214 A.D.2d 473 (1st Dept. 1995), aff'd. as modified, 87 N.Y.2d 574 (1996).

> Since the New York Franchise Sales Act was enacted specifically to prevent, combat and protect the franchisee from rampant franchise sales fraud, it is remedial in nature, and therefore, to be liberally construed. In the interpretative context, courts are obliged to 'harmonize the various provisions' of a statute to achieve its legislative purpose and thus, must read the entire law and accord respect to the interlocking and interrelated features of all its parts. *A.J. Temple*, *supra*, at 951 (citations omitted).

The Court finds that under the totality of the specific circumstances of this case as previously set forth, that the actions conducted by the plaintiffs amounted to "due diligence" and

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[5]"Hoist with his own petar", Shakespeare, Hamlet, Act III, Scene 4 (202-209) ("hoist" to lift up; petard an engineer's explosive device).

it would have been highly unlikely that plaintiffs would have discovered what they have called the fraudulent acts of TSR.

Discussion — Proof of Fraud

The Court has concluded that this transaction is subject to the New York Franchise Act as set forth in Article 33 of the General Business Law. § 687 provides in part as follows:

> 2. It is unlawful for a person, in connection with the offer, sale or purchase of any franchise, to directly or indirectly:
>
> (a) Employ any device, scheme, or artifice to defraud.
>
> (b) Make any untrue statement of a material fact or omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading. It is an affirmative defense to one accused of omitting to state such a material fact that said omission was not an intentional act.
>
> (c) Engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person.

Thus, what remains is whether the plaintiffs have proven fraud by clear and convincing evidence, that the TSR Island Park MICROS reports provided by TSR to Ward and Jachetta, and upon which they relied, were materially inflated by the inclusion of fictitious cash sales.

Is there any direct evidence of fraud? The smoking gun is the bogus MICROS guest checks.[6] The Court has already found that these receipts were not validly created for services rendered. The Court does not accept the defendants' theory that they were from a planned party (no proof of such a party was ever provided) nor that the plaintiffs created them to use to get out of this deal. But is this sufficient proof that the defendants materially inflated TSR Island Park's restaurant cash sales? On its own, it is not, but it is circumstantial proof that what they were given was not accurate.

Plaintiffs argue that they have been precluded from proving their case because TSR discarded and/or deleted all documents and computer records that they argue would have revealed

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[6]Guest checks created at 2:57 and 2:58 P.M. on November 13, 2003.

this information. Perhaps they are correct. However, this is not a situation where a "litigation hold" was in place or where the defendants knew or should have known that there would be a need to preserve the records which were allegedly destroyed (as of that date); however, it is of circumstantial value.

As to the wiping out the memory of Island Park's MICROS system after selling the restaurant, this was not an uncommon thing to do, as we learned from MICROScan's President, Irwin Fein. However, it is common for the buyer and it is the buyer that wants a "clean start" and requests the deleting of memory. What was even more unusual was the "cleaning" of the hard drive "beyond recovery." Even Mr. Fein found that unusual. But, once again, the Court cannot draw any negative inference from such a pre-litigation act by defendants; however, it is, once again, also of circumstantial value of fraud.

The defense argues that this deleted or destroyed evidence which plaintiffs now claim is so valuable to its case was available during the "due diligence" period. Thus, their failure to review it prior to closing only goes to show their due diligence was "inadequate and is insufficient to support a fraud claim by clear and convincing evidence."

The Court finds it is unlikely that the plaintiffs knew or should have known that they needed to drill down to the level of the now missing, discarded or intentionally destroyed evidence. Thus, the Court would not consider this a failure of "due diligence" on their part, nor does the Court believe that the purchaser of a franchise need be a forensic accountant, nor hire one, to meet its burden.

Was the Information That Was Provided Materially False and Misleading?

Since we do not have daily MICROS, and we do not know what they would have shown, the plaintiffs must use what they were able to obtain in discovery to show that said information provided in the due diligence period was materially false and misleading.

Plaintiffs attempt to prove the above by the detailed examination and analysis of all aspects of TSR Island Park's business from the records that were turned over and from what was eventually produced in discovery.

What have the plaintiffs shown? What were the representations made by the defendants which were misrepresentations? The plaintiffs contend it is the weekly sales figures, the MICROS reports, the profit and loss statements, and the balance sheets that were false.

It is clear that the Austin plaintiffs relied on this information. It is also fairly arguable that they reasonably relied on said documents and the Court so finds; but have they proven, by clear and convincing evidence, that these documents, the documents that comprise the representations of defendants, were false? Even in a circumstantial fraud case, as is this one, "[t]he evidence must be clear and convincing and the inference of fraud unequivocal."

The burden on the plaintiffs under our facts was a heavy one, and, in the Court's opinion, they have met that burden. No one thing, no one item proves that the proffers of the defendants in the weekly MICROS, of the profit and loss statements, or the balance sheets were false.

However, we are confronted with a mountain of circumstantial evidence:

The analysis done by Ward of cash to credit ratios before and after the closing supports the argument that cash had been injected into the Island Park Spare Rib, in reality (real cash) or on "paper" as reflected in what we call the bogus MICROS. Ward's analysis of different types of produce orders supports the fact that, while orders of certain staples were reduced with some significance between ten to twenty-five percent, the income at Island Park dropped about 4.38% (similar to drops in other TSR locations).

Based upon testimony from one or more defense witnesses that employees were sent to TSR Island Park to help out, Mr. Giambalvo created an Exhibit AK to show his version of the tipped hours argument of the plaintiffs (Exhibit 79). It was clear that the chart and its contents were based on some trial transcripts (TT, 2161) and conversations with counsel, and, eventually, was so completely without foundation that the Court rejected it. It also now rejects Mr. Giambalvo's tortured interpretation of Mr. Berg's tipped hour analysis.

Mr. Giambalvo testified as to Exhibit AU, which was selected financial data gleaned from TSR Hicksville and TSR Island Park's tax returns. From this he determined two classes of statistical information: percentage of payroll to sales and percentage of food purchases to sales for each of the two locations, Hicksville and Island Park.

Despite being faced with tax returns that showed a $24,607 end of year inventory (2002), and a 2003 return that showed no inventory in the beginning of 2003 for TSR Island Park, he still used these returns for his calculations (both returns prepared by Mr. Mayer, TSR's accountant). All Giambalvo was concerned about was that the MICROS reports equated what the sales were and that the inventory was the difference. The weight to be given to the returns prepared by Mr. Mayer is clearly a problem.

The cumulative impact of the witnesses (Viggiano, Wilson, Barcia and Gaeth) who either had conversations with Leonard Iacono or witnessed business at the TSR Island Park, support the plaintiffs' position that it (Island Park) was losing money on a weekly basis and had sales in the low to mid $30,000 range rather than the low $40,000 range (as per the spreadsheet given to Ward and Jachetta by the defendants).

Viggiano testified that TSR Island Park's weekly sales averaged "in the low 30's, 32, 33" from February to April 2003. Viggiano, whose deposition was used at trial, testified further that on a Saturday in May 2003, Leonard Iacono pulled Freddie Bianco and himself aside and told them he "was paying $15,000 to $16,000 a month out of his own pocket to keep the place [TSR Island Park] operating." (Could this have come from Commack?) At or about June 15, 2003, near the end of Viggiano's employment for TSR, Leonard Iacono yelled at him for paying overtime when "the restaurant sales for the week were only $33,000.00."

Statements made by Leonard Iacono to one or more of the above employees that "it [Island Park] was killing him that he is losing his shirt over there and it's just a huge headache"; that "we're not making no money here"; and that "we're putting money out of our own pockets to keep the place running" support the plaintiffs' position that Leonard Iacono intentionally overstated the income at the TSR Island Park.

The highly unusual purging of MICROS system at the Island Park TSR immediately prior to sale is further evidence of an intent to hide the true income at TSR Island Park. It is not so much that the system's memory was deleted, but the fact that the seller ordered it deleted, not the buyer, and that even Mr. Fein, the owner of MICROScan, found the extent of the deletion unusual ("beyond recovery"), and then not even the back up tapes were produced (apparently having been

destroyed). The fraudulent/bogus MICROS guest checks reflecting the false cash sales is clearly a very important piece of circumstantial evidence. The precipitous drop in cash sales, as compared to credit card sales, as noted when comparing the six weeks prior the closing of November 13, 2003 and the six weeks thereafter.

The cumulative impact of the witnesses (Viggiano, Wilson, Barcia and Gaeth) who either had conversations with Leonard Iacono or witnessed business at the TSR Island Park, support the plaintiffs' position that TSR Island Park was losing money weekly (it "was killing him, that he is losing his shirt over there, and it's just a huge headache"; that "we're not making no money here"; and that "we're putting money out of our own pockets to keep this place running.")

TSR Island Park was losing money weekly and not grossing the amount that Leonard Iacono indicated on the spreadsheet to Ward and Jachetta. Viggiano testified that TSR Island Park's weekly sales averaged "in the low 30 number 32, 33" from February to April 2003.

The bogus/false MICROS guest checks reflect fraudulent receipts. The precipitous drop in cash sales from six weeks after closing averaged 55% to 45%, cash to credit, while six weeks prior it was 64% cash to 36% credit. This was not insignificant, it was not gradual (as defendants claimed) and cannot be attributed to the change in ownership. The business format in no way changed during the post-sale period nor did the food.

TSR has argued that if Austin had appeared at the restaurant and "counted cash" for a week (which they argue is proper due diligence, and had been done at Port Jefferson), they would have uncovered the fraud they alleged to have been perpetrated. This, they argue, precludes "reasonable reliance", so they argue. Austin responds that the presence of seven MICROS terminals, as opposed to Port Jefferson, which had one, made it far easier for Leonard Iocono to input phony "guest checks" at any time of the night or day.

TSR seeks to rebut the statement by pointing out that it is irrelevant. The MICROS system is capable of printing a single report of all sales. All Ward and Jachetta would have to do is print a report of all sales and compare it to the cash they counted, and the number of plates or customers. TSR did not present any "physical" evidence of this, but Mr. Giambalvo testified as to how it could be done. His testimony presents a far more complex scenario than TSR argues. As

Mr. Giambalvo testified:

> A You would have days - if you are there all day long there's no opportunity to do what's been alleged here, in my opinion. So based on that assumption, you would be able to see consolidated daily MICROS which would be for the full day.
>
> You would have your split MICROS for the lunch hour and the dinner hour, and you can use that information, because this would be the next step of the due diligence. Just because you had that information doesn't mean that that's where the process ends. You then take that information and compare that to prior identical days of prior weeks, and do analysis with regard to that.
>
> Having that information and being able to compare it backwards, and look at specific items such as the average dollar per guest, and different information that's on that MICROS daily printout, consolidated daily MICROS report, you would be able to see, in my opinion, significant differences of days that the alleged fraud took place, versus the days that you were in the restaurant.
>
> I think the specific example, and I apologize if I am slightly off, was six customers and 66 plates. And so you would see those types of discrepancies that would come up. Those would be available to you on those reports. (TT, 2192: 1-22).

Mr. Giambalvo's analysis is excellent. This is not merely a "counted cash" and then compared to the daily MICROS, but it is a far more complex series of steps which the Court is not convinced is required in normal due diligence of a restaurant purchase. It is a method through which you could discover fraud if you had a hint that there was something rotten in Denmark. In this case, there was no such hint or smoking gun until after the closing.

Mr. Giambalvo argued that the destruction of all daily MICROS by the defendants, which if used properly by the plaintiffs, precluded evidence of such a fraud. It is interesting to note that the maintaining of the reports and the "Z" reports were stressed by Leonard Iacono when training his personnel, while he apparently disposed of these records for Island Park.

The "party" story created by the Iaconos to explain the bogus MICROS reports and the statement by one or both Iacono brothers that they had "$700,000 to work this problem out" when confronted by the bogus guest checks, all add further circumstantial evidence to the growing pile.

The failure of TSR to withdraw franchise fees from the account while withdrawing advertising and food fees belies their claim that there was no franchise and provides further circumstantial evidence that the failure to withdraw franchise fees was evidence of guilt, that they had committed fraud, and that they were trying to prevent this problem from blowing up while business continued at Island Park.

The produce analysis of Ward reflected that major ingredients of the TSR menu, tomatoes, potatoes, onions and mushrooms dropped between ten to twenty-five percent during the due diligence period while sales at the TSR Island Park stayed essentially even or suffered only a small decline.

The produce analysis by Giambalvo was not relevant on lettuce usage because lettuce was purchased from other suppliers (Iacono). The statistics on corn was worthless because of the small amount (zero) purchased at the beginning of the calculation period, while other items were purchased in smaller amounts and useless for statistical purposes. This all lends weight to the theory that the MICROS were inflated by the Iaconos.

The purchase of Pepsi, or better to say, the drop in purchase of Pepsi (25.6% during due diligence), while the sales volume remained generally even, adds further weight to the theory that the TSR Island Park MICROS weekly cash sales were inflated by the defendants to defraud the plaintiffs. Said sales were inflated in the vicinity of over $5,000 per week. The misrepresentations were clearly material. A misrepresentation is material to a claim of fraud if "it is the type of misrepresentation likely to be deemed significant to a reasonable person considering whether to enter into the transaction." *Greenberg v. Chrust*, 282 F.Supp. 2d 112, 119 (S.D.N.Y. 2003). Clearly inflating the sales of the business is material.

The incredibility of Leonard Iacono and his testimony about the refund button and how he used it to cover his removal of up to $6,500 per week from the Commack establishment infects any testimony of Iacono, and lends further weight to the plaintiffs' theory of inflated sales volume.

Whether the plaintiffs have proven that the money removed by defendants from Commack was injected into Island Park is not as clear, but it is clear that the Island Park sales were inflated.

The defendants have argued that they had no reason to defraud the plaintiffs into

convincing them to buy the franchise. The Court disagrees. If one is to believe the witnesses who provided a snapshot of what Leonard Iacono really thought of business at the TSR Island Park, and the Court has no reason not to believe them, as well as the multiple charts that reflect TSR Island Park's performance as compared to other TSRs, it was a drain on the Iaconos and selling the franchise and the land was well worth their while. The Court concludes Leonard Iacono acted intentionally.

Using testimony of Barcia and Viggiano about the slow periods at TSR Island Park, "Lunchtime was pretty slow. We were never really filled at lunch." (Barcia), and that entire sections of the restaurant were closed "on some nights" (Viggiano), Austin has argued this reflected how poorly the restaurant was doing. TSR counters that if this was true, then if Austin was doing its proper due diligence, they would have been there to observe such slow periods.

Austin counters that even if they had coincidentally been there on those occasions (and they would not have been there on consecutive days), having already purchased Port Jefferson, they were familiar with slow periods at a TSR and it would not have raised a red flag. The Court agrees. The Court finds that plaintiffs have proven by clear and convincing evidence that the franchisor, TSR, fraudulently misrepresented material facts to the prospective franchisee, in violation of the Franchise Act.

The Liability of Michael Iacono

TSR argues that Austin has failed to prove the liability of Michael Iacono under GBL § 691(3) (The Franchise Act).

N.Y. GBL § 691(3) states:

> A person who directly or indirectly controls a person liable under this article, a partner in a firm so liable, a principal executive officer or director of a corporation so liable, a person occupying a similar status or performing similar functions, and an employee of a person so liable, who **materially aids** in the act of transaction constituting the violation, is also liable jointly and severally with and to the same extent as the controlled person, partnership, corporation or employer.

(Emphasis Added).

Since Austin has proffered no evidence against Michael Iacono that he

"materially aided" any act or transaction at issue, he cannot be liable under the Franchise Act.

It is clear from the trial that Michael Iacono is (a) a principal of TSR Franchising Corp.; and (b) on a weekly basis he received cash payments, hundreds of dollars, which Leonard removed from Commack.

Austin further argues Michael Iacono was present on the day of closing (November 13, 2003) and had stated business was good that date. It is further argued that on Thanksgiving morning (November 27, 2003) Michael phoned Ward at his home and told him that "it wasn't what [Ward] thought" and that Iacono "had $700,000 to work with this problem"; that on November 28, 2003 Michael called Jachetta and said "I don't know what you think you got, but I have $700,000 to fix this problem" and, finally, on December 3, 2003, he attended a meeting at the Hicksville TSR where he stated the guest checks were a pre-planned party and stated he would provide proof of the party to Jachetta. No such proof has ever been provided. The Austin Parties argue that Michael Iacono had knowledge of the fraudulent scheme and took steps to prevent its discovery. Furthermore, this represents "material aid" under the Franchise Act.

It is clear to the Court that Michael received cash from Commack, most likely unreported, untaxed cash.

It is also clear that when confronted by the bogus guest checks he tried to provide an excuse for their existence and tried to make the problem disappear.

This is not proof that he materially aided in the violation of GBL § 691. The proof does not support any claim that Michael was affirmatively involved in any fraud that may have taken place prior to the closing on the TSR Island Park.

Any causes of action which are directed at or which name Michael Iacono individually are dismissed as to him.

On the other hand, Leonard Iacono is liable as a "controlling person" under the Franchise Act. He was the motivating force, and it appears the primary actor behind TSR's fraudulent scheme. He is jointly and severally liable for the damages caused to Austin for the damages it suffered in connection with the purchase of the TSR Island Park and the property related thereto.

Section 691.3 of the Franchise Act dissolves the corporate veil by making corporate officers jointly and severally liable under the FSA if they materially aid in the transaction constituting the violation.

Anthony Iacono acknowledged his daily visit to the Commack restaurant, from which he would extract cash in an indeterminate amount, but easily in the hundreds of thousands of dollars over the number of years for which amended income tax returns were eventually required. Significantly, during the time that Island Park was showing significant cash purchases, at least one of which was obviously fallacious, the cash receipts at Commack were notably and falsely reduced.

The Court further determines that the conduct by the defendants found liable was willful and material as defined in GBL § 691. Plaintiffs are entitled to rescission of the Franchise Agreement and refund of amounts paid therefore, together with interest at the rate of 6% per year from the date of purchase, November 14, 2003, and including the advance of $50,000 paid on contract on March 24, 2003. It does not appear that regularly scheduled franchise fees were subsequently electronically withdrawn from the HSBC account by franchisor, so no refunds on that account are required.

Despite termination of the franchise on April 23, 2004, Austin continued to operate under the Spare Rib name until October 14, 2004. During that six month period, the franchisor ceased inclusion of Island Park in their advertising. From the date of purchase to termination, Island Park benefitted from advertising, irrespective of whether or not it was a franchisee, and is responsible for payment to TSR of the reasonable cost for each advertising. To the extent that the language of the agreement may be indicative of the reasonable value, it priced the service at $1,200 per week.

Food purchases through the entire period of operation, benefitted Island Park, irrespective of whether or not they purchased as a franchisee or independent restaurant, and they are responsible for any unpaid balance for this service. The Court has previously concluded that management fees were so ethereal, and non-productive, that franchisee obtained no benefit from them, and is not obligated to franchisor for them.

The Counterclaims of Action No. 1 and the Claims of Action No. 4.

In Action No. 1, TSR instituted specific counterclaims that remained unresolved at the time of trial as follows:

Action No. 1 Counterclaims:

1. Second Counterclaim: Breach of the Island Park Franchise Agreement;
2. Third Counterclaim: Breach of the Management Agreement;
3. Fifth Counterclaim: Unfair Competition (Lanham Act);
4. Sixth Counterclaim: Common Law Unfair Competition;
5. Seventh Counterclaim: Unjust Enrichment;
6. Eighth Counterclaim: Breach of Contract (Specific Performance); and
8. Tenth Counterclaim: Attorney's Fees.

Also, the following claims from Action No. 4 were part of the trial:

Action No. 4 Claims:

1. Breach of Contract – Fees; and
2. Breach of Contract – Post-Term Obligations.

In that the Court has found that the defendant, TSR, fraudulently misrepresented the franchise in violation of the Franchise Act, all alleged violations based upon breach of said agreement are hereby dismissed in that the fraud in the inducement of the agreement makes it unenforceable in all respects. *Cirillo v. Slomin's, Inc.*, 196 Misc.2d 922 (Sup. Ct., N.Y. County 2003); *Merrill Lynch Pierce Fenner & Smith, Inc. v. Wise Metals Group, LLC*, 19 A.D.3d 273 (1st Dept. 2005) (contract induced by fraud subject to recision, rendering it unenforceable by the culpable party).

This same finding of fraud also vitiates the viability of the personal guarantees and is a complete defense to all claims in Action No. 4 — Fees and Post-Term Obligation flowing from a breach of said contract.

However, it is clear that Austin continued to operate the Island Park restaurant under the TSR banner until October 14, 2004, when the restaurant was shut down.

While the conduct of the TSR Defendants was such as to vitiate the obligations of the Austin Boulevard under the terms of the Franchise Agreement, there are issues with respect to the conduct of the parties subsequent to the April 23, 2004 termination letter. Specifically, plaintiffs

continued to function in the guise of a Spare Rib restaurant until October 24, 2004. Thus, gaining from the use of the name after termination, approximately an additional twenty-five weeks decision. Although defendants pulled the Island Park location from their advertising as of April 23, 2004, plaintiffs continued to use the name until the restaurant closed in October. The Court must, therefore, evaluate the conduct of the parties subsequent to the termination of the franchise in light of the TSR Defendants contentions that they are entitled to damages as a result of the unauthorized use of the TSR trademarks and trade dress, more specifically, the fifth, sixth and seventh counterclaims.

Post-Termination Conduct

The Lanham Act (sections 32 and 43 of 15 USC §§ 1114 and 1125) protects against trademark infringement. TSR had valid trademarks which Austin was allowed to use pursuant to the Franchise Agreement. The agreement was terminated as of April 23, 2004. There is no dispute that the Austin Parties continued to use TSR Franchising trademarks until October 4, 2004 (when both Port Jefferson and Island Park closed).

The Lanham Act (15 USC §§ 1114, 1125) sections 32 and 43 state in part:

> (1) Any person who shall, without the consent of the registrant – (a) use in commerce any reproduction, counterfeit, copy, or colorable imitation of a registered mark in connection with the sale, offering for sale, distribution, or advertising of any goods or services on or in connection with which such use is likely to cause confusion, or to cause mistake, or to deceive; or
>
> (b) reproduce, counterfeit, copy, or colorably imitate a registered mark and apply such reproduction, counterfeit, copy, or colorable imitation to labels, signs, prints, packages, wrappers, receptacles or advertisements intended to be used in commerce upon or in connection with the sale, offering for sale, distribution, or advertising of goods or services on or in connection with which such use is likely to cause confusion, or to cause mistake, or to deceive, shall be liable in a civil action by the registrant for the remedies hereinafter provided. Under subsection (b) hereof, the registrant shall not be entitled to recover profits or damages unless the acts have been committed with knowledge that such imitation is intended to be used to cause confusion, or to cause mistake, or to deceive
>
> and
>
> (1) Any person who, on or in connection with any goods or services, or any container for goods, uses in commerce any word, term, name, symbol, or device, or

> any combination thereof, or any false designation of origin, false or misleading description of fact, or false or misleading representation of fact, which –
>
> (a) is likely to cause confusion, or to cause mistake, or to deceive as to the affiliation, connection, or association of such person with another person, or as to the origin, sponsorship, or approval of his or her goods, services, or commercial activities by another person, or
>
> (b) in commercial advertising or promotion, misrepresents the nature, characteristics, qualities, or geographic origin of his or her or another person's goods, services, or commercial activities, shall be liable in a civil action by any person who believes that he or she is or is likely to be damaged by such act.

To prevail on a trademark infringement claim under § 32(1) of the Lanham Act, 15 USC § 1114(1), or false designation of origin under § 43(a) of the Lanham Act, 15 USC 1125(a), a plaintiff must first show that it owns a valid mark entitled to protection under the statute that the defendant used in commerce, without the plaintiff's consent and in connection with the sale or advertising of goods of services . . . The plaintiff must then show that the defendant's use of the mark 'is likely to cause consumers confusion as to the origin or sponsorship of the defendant's goods.'" *Merck & Co., Inc. v. Mediplan Health Consulting, Inc.*, 425 F.Supp. 2d 402, 410-11 (S.D.N.Y. 2006). "The standard for trademark infringement under the Lanham Act is similar to the standard for analogous state law claims." See *Bristol-Myers Squibb Co. v. McNeil-P.P.C., Inc.*, 973 F.2d 1033, 1048 (2d Cir. 1992).

To establish a claim for passing off, also known as reverse palming off, "the plaintiff must allege '(1) that the work at issue originated with the plaintiff; (2) that [the] origin of the work was falsely designated by the defendant; (3) that the false designation was likely to cause consumer confusion; and (4) that the plaintiff was harmed by the defendant's false designation of origin.'" *Lipton v. The Nature Co.*, 71 F.3d 464, 473 (2d Cir. 1995).

TSR argues that under the Lanham Act, 650, Ward, Jachetta and Austin are liable to TSR Franchising for damages (as are Ward and Jachetta individually under the guarantees) because the use of the trademarks "is likely to cause confusion, or to cause mistake, or to deceive " 15 USC 1125(a) and the use was intended . . . to cause confusion, or to cause mistake, or to deceive." (Id.)

As to damages, which may be assessed for such a violation, 15 USC § 1117 states as follows:

> (a) Profits; damages and costs; attorney fees. When a violation of any right of the registrant of a mark registered in the Patent and Trademark Office, a violation under section 43(a) or (d) [15 USCS § 1125(a) or (d)], or a willful violation under section 43(c) [15 USCS § 1125(c)], shall have been established in any civil action arising under this Act, the plaintiff shall be entitled, subject to the provisions of sections 29 and 32 [15 USCS §§ 1111, 1114], and subject to the principles of equity, to recover (1) defendant's profits, (2) any damages sustained by the plaintiff, and (3) the costs of the action. The court shall assess such profits and damages or cause the same to be assessed under its direction. In assessing profits the plaintiff shall be required to prove defendant's sales only; defendant must prove all elements of cost or deduction claimed. In assessing damages the court may enter judgment, according to the circumstances of the case, for any sum above the amount found as actual damages, not exceeding three times such amount. If the court shall find that the amount of the recovery based on profits is either inadequate or excessive the court may in its discretion enter judgment for such sum as the court shall find to be just, according to the circumstances of the case. Such sum in either of the above circumstances shall constitute compensation and not a penalty. The court in exceptional cases may award reasonable attorney fees to the prevailing party.

Thus, "profits", argues TSR, would be the sales of TSR Island Park unless reduced by costs introduced by the Austin Parties. The sales were $557,249.08. (See Exhibits J and K). Therefore, TSR requests three times that amount plus legal fees (pursuant to the Franchise Agreement and the Lanham Act). TSR also contends that Austin failed to produce any evidence to offset sales. That is incorrect. Exhibit 39, which reflected the break even analysis, Exhibit 41 (Quick Books), Exhibit 45 (Form 1120S) and Exhibit 69 (invoices reflecting payments to vendors in 2004), all show costs that kept Island Park Spare Rib operating in 2004. All of which show Island Park operated at a significant loss in 2004, and TSR has not shown a reduction in business at other TSR locations.

Ward and Jachetta do not deny they continued using the TSR trademarks (signs and logo). TSR contends this was "intended . . . to cause confusion, or to cause mistake, or to deceive." (15 USC 1125(a)). TSR contends there could be no doubt that anyone seeing signs on the Port Jefferson or Island Park locations, or sitting inside them, would believe they were sitting in a Spare Rib restaurant.

Austin argues that TSR Franchising's counterclaims are defective because TSR Franchising failed to adduce any evidence of actual consumer confusion. "The actual consumer

confusion standard is satisfied once a plaintiff has produced evidence of at least one instance of such confusion." *Warner Bros., Inc. v. Gay Toys, Inc.*, 658 F.2d 76, 79 (2d Cir. 1981). At trial, TSR Franchising failed to produce such evidence.

Austin has also argued that even assuming, arguendo, that this Court finds actual consumer confusion, this Court may only award damages upon a finding that TSR Franchising "successfully show[ed] (1) causation and (2) the amount of damages suffered from the infringement." *Life Industries Corp. v. Ocean Bio-Chem, Inc.*, 827 F.Supp. 926, 933 (E.D.N.Y. 1993). Evidence of causation and damages "must be sound and the amount of damages must not be speculative." (*Id.*). At trial, TSR Franchising did not proffer any evidence on causation or actual damages. Indeed, the only testimony relating to these elements was Leonard Iacono's statement that after the commencement of Action No. 1, TSR Franchising, an admittedly fledgling franchisor, did not grant any new franchises. (TT, 1953:6-9). However, Leonard Iacono did not testify that TSR Franchising made any effort whatsoever to secure new franchises. Perhaps the Iaconos were soured by their Island Park experience, or, perhaps, there were other factors involving Commack that came into pay. Under the circumstances, TSR Franchising's proof on causation and damages is entirely speculative.

Essentially we have a clear use of TSR's name and logo for six months after the franchises were terminated. We have TSR's argument that anyone sitting in Island Park (or Port Jefferson) after April 23, 2004, would believe they were in a TSR restaurant, ergo obvious confusion, or at least "likelihood of confusion." However, there has been no proof of such "confusion" nor that the "likelihood of confusion" is causally related to damages.

There has been no proof of unjust enrichment of the Austin Parties under our facts. There has been no proof that TSR has been damaged from the infringement (no causation related to damages), and, finally, there is no indication under our facts that defendants' profits (if there were any) should be awarded under a deterrence theory. (The likelihood of a recurrence of this scenario is, at best, nil.)

There is also the argument that, despite the franchise termination as of April 24, 2004, there were continued negotiations and no request by TSR to have Austin stop the use of TSR's

name and logo. The request by TSR, via an Order to Show Cause to restrain the use of the name and logo, came six months after franchise termination. There was no evidence that any of the business at the TSR Island Park or TSR Port Jefferson would have gone to either of the other two TSR locations. In fact, without a scientific study, there is no indication that customers of Island Park and Port Jefferson TSRs might now be likely to go to Hicksville and/or Commack, or vice versa. There is no evidence that the actions of the plaintiffs in running either Port Jefferson or Island Park in any way diluted the reputation of the other TSRs.

It should not be forgotten that TSR pulled advertising from Port Jefferson and Island Park and also excluded them from the Rib Rewards Program (as they had the right to do upon terminating the franchises), which allegedly reduced even further the weak sales at Island Park.

Finally, it is clear that equitable principles apply to the Lanham Act. *Pedinol Pharmaceuticals, Inc. v. Rising Pharmaceuticals, Inc.*, 570 F.Supp.2d 498. The *Pedinol* court concluded that a plaintiff was not automatically entitled to all of defendant's profits over the time period in question.

Considering all of the above, there is a dearth of evidence to support TSR's damages claim, and, thus, all claims for damages under the Lanham Act or its New York counterpart are denied, as well as the claim for unjust enrichment (seventh counterclaim).

This matter is referred to Court Attorney/Referee Frank Schellace (Room 060, Special 2 Courtroom, Lower Level) on July 26, 2010, at 9:30 A.M., to determine damages to which plaintiffs are entitled pursuant to the Court's ruling.

Dated: June 10, 2010

J.S.C.