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

PRESENT: BARBARA R. KAPNICK J.S.C. Justice PART 39

Index Number : 601008/2007

DIVERSIFIED INVESTORS CAPITAL

VS.

VERTICAL BRANDING INC

SEQUENCE NUMBER : 003

SUMMARY JUDGMENT

INDEX NO.

MOTION DATE

MOTION SEQ. NO.

MOTION CAL. NO.

this motion to/for

FILED
PAPERS NUMBERED
JUL 20 2010
COUNTY CLERK'S OFFICE
NEW YORK

Notice of Motion/ Order to Show Cause — Affidavits — Exhibits ...

Answering Affidavits — Exhibits

Replying Affidavits

Cross-Motion: ☐ Yes ☒ No

Upon the foregoing papers, it is ordered that this motion is decided in accordance with the accompanying memorandum decision.

FILED
JUL 20 2010
COUNTY CLERK'S OFFICE
NEW YORK

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

Dated: 7/12/10

BARBARA R. KAPNICK J.S.C.

Check one: ☐ FINAL DISPOSITION ☒ NON-FINAL DISPOSITION

Check if appropriate: ☐ DO NOT POST ☐ REFERENCE

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SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK: IAS PART 39

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DIVERSIFIED INVESTORS CAPITAL SERVICES OF N.A., INC.,

Plaintiff,

-against-

VERTICAL BRANDING, INC. and WORLDWIDE EXCELLENCE, INC.,

Defendants.

DECISION/ORDER
Index No. 601008/07
Mot. Seq. Nos. 003 and 004

BARBARA R. KAPNICK, J.S.C.:

Motions sequence numbers 003 and 004 are consolidated for disposition.

In motion sequence no. 003, defendants Vertical Branding, Inc. ("VBI") and Worldwide Excellence, Inc. ("WWE") move, pursuant to CPLR § 3212, for summary judgment dismissing the Complaint, or in the alternative, for partial summary judgment as to any claims alleged by plaintiff for recovery of sums arising from any commissions or "finder's fees" tied to post-merger financing transactions.

Plaintiff Diversified Investors Capital Services of N.A., Inc. ("Diversified") opposes the motion and moves, under motion sequence number 004, for *partial* summary judgment

(i) on the first cause of action, in the sum of: (a) $90,000 for monthly consulting fees; (b) $160,500 for consulting or finder's fees related to the funding of a private placement memorandum ("PPM"); (c) $72,300 for its unaccountable expense

allowance; and (d) $5,744.59 for reimbursement of printing and legal fees relating to the PPM;[1] and

(ii) on the second cause of action, (a) compelling defendants to issue and deliver to Diversified or its designee three (3) year warrants for 200,000 shares of registered common stock of VBI, with an exercise price of $1.00; and (b) for three (3) year warrants of 107,500 preferred units of VBI as defined in the PPM.

Plaintiff Diversified is in the business of financial and other consulting to start-up and emerging companies.

Defendant VBI, formerly known as MFC Development Corp. ("MFC"), is a publically traded holding company. Defendant WWE, a wholly-owned subsidiary of VBI, is in the business of direct marketing and product branding, specializing in health, beauty, fitness, self-help and home consumer products.

On or about May 19, 2005, Diversified and WWE entered into a Management and Consulting Agreement and a letter addendum to the Management and Consulting Agreement (collectively referred to herein as the "Agreement").

Pursuant to the Agreement, WWE engaged plaintiff to assist it in effecting a reverse merger, whereby WWE would become a wholly

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[1] Plaintiff does not seek summary judgment on that portion of its first cause of action seeking $288,750 for consulting or finder's fees related to post-merger fundings.

owned subsidiary of a publicly traded shell company of which WWE's shareholders would then have voting control, and which WWE's management would run. *See generally SEC v Cavanagh*, 445 F3d 105, 108 n 4 (2nd Cir 2006).

The Agreement provided, among other things, that Diversified would assist WWE in preparing an updated business plan, provide advice with regard to potential acquisition candidates, and introduce WWE to financing sources. There is no dispute that Diversified introduced WWE to VBI, the company with which WWE effected the reverse merger; assisted in WWE's securing of a bridge loan; structured the PPM through which WWE would seek the funding that it required; and solicited and helped to bring about some of the investments that made the merger possible. It is also undisputed that WWE paid Diversified a portion, but only a portion, of the fees and warrants that are provided for in the Agreement. Unfortunately for Diversified, it is also undisputed that neither it, nor its owner, nor any of its employees, is registered with the Securities and Exchange Commission ("SEC") as a broker.

Section 15 (a) of the Securities and Exchange Act, 15 USC § 78o(a)(1), makes it unlawful for brokers, other than those whose business is exclusively intrastate, "to make use of the mails or any means or instrumentality of interstate commerce ... to induce or attempt to induce the purchase or sale of, any security" unless such broker or dealer is registered with the SEC. 15 USC §

78c(a)(4)(A) defines "broker" as "any person engaged in the business of effecting transactions in securities for the account of others." Indicia of being a broker include the solicitation of investors, participating in the securities business with some degree of regularity, and receiving transaction-based compensation. *SEC v Rabinovich & Associates, LP*, 2008 WL 4937360 at * 5 (SDNY 2008); *SEC v Martino*, 255 FSupp 2d 268 (SDNY 2003).

Regularity of participation in the securities business is shown by, among other activities, substantial solicitation of investment in securities. *SEC v Deyon*, 977 F Supp 510 (D Me 1997), *affd* 201 F3d 428 (1st Cir 1998). In order to be a "broker," one need not purchase securities for the account of another; it suffices if one solicits buyers or acts as a middleman. *SEC v Martino*, *supra* at 283.

Herman Finesod, plaintiff's managing director, testified at his deposition that in addition to introducing potential investors to WWE, he recommended WWE as an investment and that he had persuaded at least one potential investor, who was reluctant to make an investment, to change his mind. Accordingly, Mr. Finesod acted, at least in part, as a broker.

15 USC § 78cc (b) provides, in relevant part, that:

> Every contract made in violation of any provision of this chapter ... and every contract ... heretofore or hereafter made, the performance of which involves the violation of ... any provision of this chapter ... shall

> be void (1) as regards the rights of any person who, in violation of any such provision ..., shall have made or engaged in the performance of any such contract ... .

In *Mills v Electric Auto-Lite Co.* 396 US 375, 387 (1970) (footnote omitted), the U.S. Supreme Court held that this provision precludes a "guilty party ... from enforcing the contract against an unwilling innocent party," although, as regards the rights of an innocent party, the contract is voidable, rather than void.

Defendants argue that their motion must be granted, and that plaintiff's motion must be denied, because plaintiff induced the purchase of securities, without ever having registered as a broker. Citing *Cornhusker Energy Lexington, LLC v Prospect St. Ventures* 2006 WL 2620985 at *8 (D Neb 2006), quoting *Occidental Life Ins. Co. v Pat Ryan & Associates, Inc.*, 496 F2d 1255, 1266 (4th Cir 1974), plaintiff contends that courts are reluctant to allow rescission when the violator has performed its contractual duties.

Plaintiff's reliance on these cases, however, is misplaced, since rescission is an equitable remedy, subject to equitable defenses. Here, defendants are not seeking to rescind the Agreement; rather, plaintiff is seeking to enforce it. It is precluded from doing so to the extent that it seeks compensation for its activities as a broker.

However, plaintiff is not precluded from recovering payment for its activities as a finder, or as a consultant, and the fact that the Agreement provides that plaintiff's compensation is contingent upon the effectuation of the reverse merger and the raising of the required capital does not dictate the conclusion that all of the compensation provided for constituted payment for securing the financing.

For example, the Agreement provides that plaintiff would receive a 5% fee on investments made by investors who were not directly, or indirectly, introduced by plaintiff, and that plaintiff would be paid a monthly consulting fee of $5,000 for 18 months. It cannot reasonably be disputed that a significant portion of the compensation provided for in the Agreement was intended as payment for plaintiff's work in preparing the PPM, as well as other work performed by plaintiff, as distinguished from plaintiff's work to secure funding for the merger. Consequently, defendants have failed to show that the entire Agreement is unlawful, or that they are entitled to dismissal of the entire Complaint, as a matter of law.[2]

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[2] This Court notes that the Agreement does not expressly refer to plaintiff's work in soliciting investments. It is clear, however, that the parties understood such activity to be central to their agreement. Thus, Mr. Finesod testified at his deposition as to how effective he had been in securing investments, while Nancy Duitch, the Chief Executive Officer of the defendants, testified as to how poorly he had performed in that regard.

However, defendant is entitled to the partial summary judgment that it seeks. One of the claims in plaintiff's first cause of action is for $288,750 for consulting or finder's fees related to post-merger fundings. Plaintiff contends that it introduced a Mr. Bob Prag to WWE and that Mr. Prag, in turn, introduced defendants to Gottbetter Capital Finance, LLC, to which VBI sold certain secured convertible notes so as to raise $5,775,400. The letter addendum to the Agreement provides in Paragraph 2, that after the merger has been effected, plaintiff "shall have the exclusive on firms or companies that have shown interest in funding for WWE, and for which we have identified in writing prior to the closing of the public merger, to WWE."

Mr. Finesod acknowledged at his deposition on January 14, 2009 that while he gave WWE written notice of some of the potential individual investors, he had not given it written notice of any companies from which WWE might obtain funding. (Transcript, pages 238-239). Accordingly, defendants are entitled to partial summary judgment dismissing only that portion of plaintiff's first cause of action seeking recovery of consulting or finder's fees for post-merger fundings.

Plaintiff's motion for partial summary judgment is denied, because plaintiff has not shown that the particular items of compensation that that motion addresses are not related to plaintiff's solicitation of investments. Moreover, there are

factual disputes as to what work plaintiff actually did perform. For example, Jeffrey Edell, the Chief Executive Officer of WWE at the time of the merger, testified at his deposition on February 5, 2009 that plaintiff "did nothing for [WWE] in terms of consulting, zero." (Transcript, page 82).

Accordingly, it is hereby

ORDERED that defendants' motion for summary judgment (motion sequence no. 003) is granted only to the extent of dismissing that part of the first cause of action which seeks compensation for post-merger fundings, and the motion is otherwise denied; and it is further

ORDERED that plaintiff's motion for partial summary judgment (motion sequence no. 004) is denied.

Counsel for both parties shall appear in IA Part 39, 60 Centre Street, Room 208 on August 4, 2010 at 10:00 a.m. to schedule a trial date for the remaining claims in this case.

This constitutes the decision and order of this Court.

Dated: July 12, 2010

Barbara R. Kapnick
J.S.C.

BARBARA R. KAPNICK
J.S.C.