SUPREME COURT OF THE STATE OF NEW YORK
NEW YORK COUNTY: COMMERCIAL DIVISION

PRESENT: HON. JENNIFER G. SCHECTER **PART** 54
Justice

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JANET HAN, SWEETCATCH KKA LLC,

Plaintiffs,

- v -

ROBERT KWAK, JOSEPH KO, ANTHONY PANTANO, NC KKA LLC,

Defendants.

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INDEX NO. 654281/2018

DECISION AFTER TRIAL

This case ultimately turns on a purely legal question: whether rescission or rescissory damages are available solely against a defendant who is not a party to the transaction that he fraudulently induced. Because New York law establishes that such relief is not available and because plaintiff Janet Han did not pursue other potential damages, judgment must be entered in favor of defendant Robert Kwak despite evidence clearly and convincingly proving that he defrauded her.

The credible evidence at trial established that defendant Kwak made material misrepresentations to plaintiff Han to induce her $1 million investment in Sweetcatch KKA LLC (the Company). The Company owns LLCs that were intended to operate numerous poke restaurant locations in Manhattan. By investing in the Company, Han acquired an interest in the entire business rather than in any particular restaurant location. Han credibly testified that Kwak represented that her investment would principally be used to fund a new restaurant location. In reality, Kwak knew that the Company would instead use her money to pay for losses already incurred on failed or existing locations. The court credits Han's testimony that she never would have invested if she had been aware of this fact. The premise of plaintiff's investment was a lie.

Kwak contends that plaintiff has not proven, by clear and convincing evidence (*see Rudman v Cowles Communications, Inc.*, 30 NY2d 1, 10 [1972]), that her reliance on his representations was justifiable because she could have discovered his fraud with reasonable diligence (*see HSH Nordbank AG v UBS AG*, 95 AD3d 185, 195 [1st Dept 2012]). He avers, for instance, that plaintiff failed to discover information available online about the original location and that she did not make a meaningful inquiry into the Company's finances. In other words, Kwak argues that industry due diligence is no substitute for financial due diligence—that is, a deep dive on the poke space and the price of fish was not enough. That issue is academic.

DECISION AFTER TRIAL

There is a threshold problem with plaintiff's claim for rescission based on Kwak's fraud that is fatal to her case. Han cannot obtain rescission or rescissory damages from Kwak because he is not her contractual counterparty. Plaintiff was cautioned about the importance of this issue at trial and was directed to provide authority in her post-trial brief demonstrating that privity is not required to obtain rescissory relief. She did not do so. Rather, as explained below, she merely provides authority for the uncontroversial proposition that damages may be sought from a nonsignatory that fraudulently induces entry into a contract (*see Uniflex, Inc. v Olivetti Corp. of Am.*, 86 AD2d 538 [1st Dept 1982], *accord John Blair Communications, Inc. v Reliance Capital Group, L.P.*, 157 AD2d 490, 492 [1st Dept 1990] ["Privity is not an element of intentional fraud"]; *see also Allenby, LLC v Credit Suisse, AG*, 134 AD3d 577, 581 [1st Dept 2015]). A legal claim for fraud seeking out-of-pocket damages, however, is very different from an equitable claim for rescission (*Sokolow, Dunaud, Mercadier & Carreras LLP v Lacher*, 299 AD2d 64, 71 [1st Dept 2002]; *see Empire Outlet Builders LLC v Construction Resources Corp. of New York*, 170 AD3d 582, 583 [1st Dept 2019]; *see also VisionChina Media Inc. v Shareholder Representative Servs., LLC*, 109 AD3d 49, 56 [1st Dept 2013]). To understand why that difference is critical here and why plaintiff's election of remedies was necessary and not prejudicial, examination of the case's procedural history is warranted.

Plaintiff commenced this action on August 28, 2018. Originally, she asserted a direct claim for fraud against Kwak and derivative breach-of-fiduciary-duty claims against Kwak, NC KKA LLC (the Managing Member) and its other members (Dkt. 1). On February 28, 2019, plaintiff filed an amended complaint with essentially the same causes of action, which remains the operative pleading (Dkt. 20). Plaintiff filed a note of issue on October 15, 2021, requesting a jury trial (Dkt. 64).

During the pre-trial conference on September 16, 2022, which was held without the benefit of plaintiff's court-ordered pre-trial filings, the court identified problems with the claims that plaintiff intended to try before a jury, including that: (1) a jury trial was not proper on her equitable claims (the portion of the fraud claim seeking rescission and her derivative claims); (2) plaintiff could not seek both rescission and derivative recovery since the former would deprive her of standing on the latter; and (3) since plaintiff did not intend to call an expert at trial, she had no way of proving out-of-pocket damages on the portion of her fraud claim that could be tried by a jury--she could not prove the difference in value between what she contracted for and its allegedly actual lesser value (*see* Dkt. 103). The court directed plaintiff's counsel to discuss these issues with his client and notify the court on how plaintiff planned to proceed.

By letter dated October 3, 2022, plaintiff wrote "to advise the Court that Plaintiff has elected the remedy of rescission on her claim for fraud" and that plaintiff "understands that this election means that the case will proceed to a bench trial as opposed to a jury trial" (Dkt. 87). He further wrote that "based on my research at the Court's suggestion, I do not see any procedural impediment to Plaintiff proceeding to trial on her direct and derivative

claims at the same time" (*id.*). By order dated October 4, 2022, the court noted plaintiff's election but explained why, under these circumstances, plaintiff could not proceed with her derivative claims while also seeking rescission (Dkt. 88).

A bench trial was held from June 5-7, 2023 (Dkts. 121-123), after which the parties filed post-trial briefs (Dkts. 120, 126). Those briefs address the penultimate question here, which is significant because Kwak is not a party to the subscription agreement that Han seeks to rescind (Dkt. 112). The agreement is between Han and the Company, with Kwak having executed it as the manager of the Managing Member (*see id.* at 5). Despite the critical import of this issue, Kwak merely cites a trial court case holding that privity is necessary (*see* Dkt. 120 at 13) and Han relies on an inapposite Appellate Division case, which does not address the availability of rescission as a remedy and holds that privity of contract is not required to assert a claim and recover damages for fraudulent misrepresentation (*Uniflex*, 86 AD2d 538).

Plaintiff also objects to the court creating "entirely new law by dismissing the fraud claim against [Kwak] because he was not a party to the subscription agreement" (*see* Dkt. 126 at 21). Settled law, however, compels judgment in favor of Kwak because rescission is unavailable as a remedy against him and Han did not have any evidence of out-of-pocket damages.

Rescissory Damages Are Unavailable Absent Privity

Both the Supreme Court and the Second Circuit have interpreted a 1928 case from the Court of Appeals to have held that, under New York law, rescission is permitted "against a defendant who was not a party to the contract" (*Pinter v Dahl*, 486 US 622, 647 n 23 [1988], citing *Keskal v Modrakowski*, 249 NY 406, 408 [1928]; *see Gordon v Burr*, 506 F2d 1080, 1083 [2d Cir 1974] ["New York courts have long held rescission applicable against a defrauder not in privity of contract with the victim of the fraud"], *accord Loreley Fin. (Jersey) No. 3 Ltd. v Wells Fargo Secs., LLC*, 2016 WL 5719749, at *3 [SDNY Sept. 29, 2016] ["where, as here, an action for rescission under New York law is predicated on fraud, the rescission claim may be applicable against a defrauder not in privity of contract with the victim of the fraud to the extent the defrauder defendant induced the victim to make the purchase"]). That is not, however, what the Court of Appeals actually decided and is inconsistent with controlling holdings of the Appellate Division.

Appellate Division cases establish that a rescission claim may only be asserted against parties in privity of contract (*McGarry v Miller*, 158 AD2d 327, 328 [1st Dept 1990] [holding that plaintiff might have a claim for rescission against contractual counterparty but that since "M & M was not a party to the contract, no such cause of action may be alleged against it"], *accord Steinberg v Sherman*, 2008 WL 2156726, at *7 [SDNY May 8, 2008] ["A claim for rescission cannot be maintained against a person who was not a party to the contract. This is true even where that individual joined in the false representations

that induced the contract"]; *see Alexander City Bank v Equitable Trust Co. of New York*, 223 AD 24, 28 [1st Dept 1928] ["in rescinding a contract and enforcing rights growing out of such rescission, **one may only look to the other party to the contract**"] [emphasis added]; *see also Jesmer v Retail Magic, Inc.*, 55 AD3d 171, 182-83 [2d Dept 2008] ["Auto–Star conclusively established that First Americans' purchase of the POS system from Magic did not create a contractual relationship between First Americans and Auto–Star. Consequently, the Supreme Court properly granted those branches of Auto–Star's motion which were to dismiss the first cause of action for rescission of the purchase agreement"], *accord Maciel v BMW of N. Am., LLC*, 2021 WL 983013, at *9 [EDNY Feb. 22, 2021] ["the court in *Jesmer* held that no contractual relationship existed between the plaintiff and the developer because the plaintiff purchased the computer system from a distributor, and consequently affirmed dismissal of a rescission claim against the developer"]).

The Court of Appeals did not actually hold to the contrary in *Keskal*. Rather, it merely explained that a nonsignatory could be held liable for damages (*see Keskal*, 249 NY at 408 ["**If the theory of the plaintiffs' action were fraud instead of contract**, the defendant on proof of the fraud might be subject to a duty, equally with the corporation, **to make restitution** to subscribers"] [emphasis added]). The Court's statement about "restitution" was dicta as the claim there was for breach of contract, and not fraud. The *Keskal* Court relied on *Mack v Latta* (178 NY 525 [1904]) for that proposition. In *Mack*, the question was whether a court entertaining an equitable claim for rescission based on fraud against a defendant company in contractual privity with plaintiff could also entertain a claim for damages against the nonsignatory individual defendants that personally made the misrepresentations (*see id.* at 527). In holding that plaintiff could do so as against both parties in one action, the Court explained that the claim asserted against the company is "for a rescission of the contract" and that the claim against the individual defendants is "**an action at law for damages** for their fraud" (*id.* at 528-29 [emphasis added]; *see also id.* at 529-30 ["if plaintiff had brought this action against the corporation alone, and obtained a judgment canceling the contract and awarding him the $100,000 advanced, with interest, and he should have failed to collect from the corporation by reason of its lack of assets, he could undoubtedly have collected the balance unpaid **in an action at law** against the officers whose fraudulent representations had induced the contract"] [emphasis added]). The precise ramifications of *Mack* and its implications on later-more-developed corporate and legal principles are unclear. What is clear, however, in addition to Appellate Division precedent establishing that rescission is unavailable here, is that the Company was never sued and rescission was never sought against the party that was the recipient of the investment.

Plaintiff therefore cannot seek rescission from Kwak.

After all, "rescission can be effective only by returning or tendering back the consideration received" (*Kamerman v Curtis*, 285 NY 221, 226 [1941]). A nonsignatory who was not the recipient of the consideration cannot restore the status quo (*see Sokolow,* 299 AD2d at

71). Restoration of the status quo on plaintiff's rescission claim would entail her giving back her membership interest in the Company, while receiving back her $1 million investment. Kwak was not personally the recipient of her $1 million investment and is not the party that provided her with a membership interest in the Company. They are not in privity. Rather, plaintiff's money was paid to the Company in consideration for the membership interest (*see* Dkt. 79 at 60) and was then used by it to pay debts (including, to be sure, Kwak's $200,000 loan). Ordering Kwak to pay plaintiff $1 million in exchange for her membership interest as rescission is not permitted under New York law (*see MBIA Ins. Corp. v Countrywide Home Loans, Inc.*, 105 AD3d 412, 413 [1st Dept 2013] [rescissory damages may not be awarded when "rescission is not warranted"]). While plaintiff could have elected to proceed with her legal claim for damages against Kwak, the ship sailed on that long ago.* At the time of the October 4, 2022 order, the court was cognizant that plaintiff had elected to forego her claim for out-of-pocket damages against Kwak, which settled law conceptually would permit. In any event, plaintiff had no expert so proceeding to a jury trial would have been absolutely pointless. Where, as here, a party lacks proper evidence of damages on a fraud claim (i.e., the difference between what the interest in the company was worth at the time of the sale due to the fraud and what she paid for it), the claim must be dismissed as a matter of law (*Danco Enterprises, LLC v LiveXLive Media, Inc.*, 209 AD3d 428, 429 [1st Dept 2022]). That is what would have happened had Kwak moved for summary judgment, and that is what would have happened had plaintiff proceeded to a jury trial on that claim (*see id.*; *see also Kumiva Group, LLC v Garda USA Inc.*, 146 AD3d 504, 506 [1st Dept 2017]). It was inescapable and plaintiff could not reframe such a claim as one for rescissory damages as an end-run around that rule (*see Ambac Assurance Corp. v Countrywide Home Loans, Inc.*, 31 NY3d 569, 580 [2018]).

Of course, plaintiff always really wanted all of her money back because she was fundamentally deceived about the nature of her investment and not merely about its worth (*see Sabby Healthcare Master Fund Ltd. v Microbot Med. Inc.*, 180 AD3d 529, 530 [1st Dept 2020]). Thus, an equitable rescission claim, rather than a legal claim seeking out-of-pocket damages, had more intuitive appeal. The problem is that, from the outset of the case in her pleading, plaintiff never asserted the fraud claim against anyone other than Kwak (perhaps because the Company does not have the money to pay any judgment), even though she asserted claims against other defendants. So while plaintiff may have prevailed

* Plaintiff could not have maintained any derivative claims either. Indeed, based on the pretrial conference and the evidence at trial, the court still does not even understand the specific grounds for the derivative claims or the damages to the Company. That plaintiff's money was used for different subsidiary LLCs than represented to plaintiff did not harm the Company and, if anything, the Company benefitted from its subsidiaries' debts being paid. At no point were any double derivative claims based on harm to the subsidiaries ever pleaded. To the extent the derivative claims concern the failure of the Company due to mismanagement, plaintiff has never explained why that claim is based on anything other than poor decisions that are protected by the business judgment rule.

if she pleaded the fraud claim against the Company or hired a damages expert at the discovery stage, those possibilities were foreclosed long ago.

Plaintiff protests, based on the procedural developments of this case, that it would be unfair to rule against her on this ground. The court disagrees. Even if this issue were not even raised at trial, since it is a dispositive pure issue of law, Kwak could have raised it for the first time on appeal (*Basis Yield Alpha Fund Master v Morgan Stanley*, 136 AD3d 136, 141 n 4 [1st Dept 2015], citing *Vanship Holdings Ltd. v Energy Infrastructure Acquisition Corp.*, 65 AD3d 405, 408 [1st Dept 2009]). This court cannot disregard the threshold legal rule that fundamentally a rescission claim may not be maintained absent privity nor can the court turn a blind eye to the requirements of proving damages.

Accordingly, it is ORDERED that the Clerk is directed to enter judgment dismissing the remaining first cause of action for fraud against defendant Robert Kwak with prejudice.

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DATE: 9/14/2023 **JENNIFER G. SCHECTER, JSC**

Check One: [X] **Case Disposed** [ ] **Non-Final Disposition**