IN THE FRANKLIN COUNTY COURT OF COMMON PLEAS
FRANKLIN COUNTY, OHIO

JEFFREY STARNER	**CASE NO. 15-CV-009115**
PLAINTIFF,	**JUDGE KIMBERLY COCROFT**
VS	
MERCHANTS HOLDING LLC	
DEFENDANT.	

PLAINTIFF'S RESPONSE OPPOSING DEFENDANT'S MOTION FOR RELIEF FROM JUDGMENT PURSUANT TO RULE 60(B) FILED 11/17/2015

I. INTRODUCTION

Plaintiff Jeff Starner ("Plaintiff") sold his trucking business[1] (the "business" or the "Companies") to Defendant Merchants Holding LLC ("Defendant") in July 2014.[2] His family had owned and operated the business for over 40 years. Ex. A - Starner Aff. ¶ 5, filed herewith. The three most important components of the sale were: (1) Defendant promised to infuse $350,000 to $500,000 of working capital into the business; (2) Defendant assumed debts, upon which Plaintiff remained personally guaranteed; and, (3) Defendant promised to pay Plaintiff $400,000 – represented by the Cognovit Note. *See* Purchase Agreement.

Defendant destroyed the Companies in less than 12 months. Defendant never contributed the promised working capital and never had it to begin with. Instead, Defendant fraudulently transferred money to insiders, sold off the Companies' most valuable assets and left Plaintiff alone to pay back over $800,000 in personally guaranteed notes. *See* Affidavits of Jeffrey Starner and

[1] The trucking "business" actually consisted of two entities; Merchants 5 Star Ltd (the operating entity) and Merchants 5 Star, Inc. (the asset owning entity).

[2] The sale is the subject of the Stock and Membership Interest Purchase Agreement referred to in Defendant's motion ("Purchase Agreement").

Robert Onda, attached herewith.

Plaintiff was forced to take the Companies back and put them into receivership.[3] Creditors sued the Companies, Defendant and Plaintiff, personally.[4] Defendant didn't defend itself or Plaintiff in those lawsuits. Now, Defendant conjures up sham defenses to avoid paying the Cognovit Note it used to obtain the Companies. Defendant's motion should be denied.

II. SUMMARY OF THE ARGUMENTS

Defendant alleges the following in its motion: (1) Plaintiff fraudulently induced it to enter the Purchase Agreement; (2) Plaintiff's *post-transaction* misconduct interfered with Defendant's ability to pay the note; and, (3) Defendant claims it made a $2,000 partial payment.

The Court should deny Defendant's motion. First, Defendant's fraudulent inducement defense fails because (a) the Purchase Agreement disclaimed the alleged representations, (b) the claimed representations were easily verifiable, and (c) Defendant fails to support its motion with sufficient operative facts. Second, *post-transaction* "misconduct" does not support recognized defenses to a cognovit judgment. Third, Defendant's fraud and misconduct defenses are barred by res judicata. Fourth, Defendant did not make the partial payment claimed. Last, justice requires that Defendant's motion be denied. Rule 60(B) provides an equitable remedy. Defendant obtained the Companies through fraud and caused their financial collapse. Defendant cannot come into equity with unclean hands. Defendant's motion was submitted in bad faith.

III. FACTUAL BACKGROUND

The Purchase Agreement was executed on July 18, 2014. *See* Purchase Agreement. Other agreements were incorporated therein such as the Cognovit Note and the Employment Agreement

[3] Franklin County Common Pleas Court, Case No. 15-CV-006200 (J. French); Starner Aff. ¶ 60.

[4] *Leverity v. Merchants 5 Star Ltd et al*, Cuyahoga County Common Pleas Court, Case No. CV-15-847302 (Judge Russo); and, *Bates v. Merchants Holding LLC et al*, Franklin County Common Pleas Court, Case No. 15-CV-006657 (Judge Frye).

referred to in Defendant's motion. *Id*. Defendant's attorney and investment banking firm analyzed the Companies' financial information, assets and liabilities prior to the sale. Starner Aff. ¶ 22. Every semi-truck and trailer was identified by serial number. Starner Aff. ¶ 34. Every loan was identified by lender and account number. Starner Aff. ¶ 34-34. Armed with this information, Defendant declared the Companies "unsafe" to invest in. Starner Aff. ¶ 23, Ex. A-3. Nevertheless, Defendant agreed to "buy" the Companies for a promissory note and promised to turn them around with an infusion of badly-needed working capital. Starner Aff. ¶ 24-25; Purchase Agreement.

By early 2015, it was clear Defendant was not paying the Companies' bills or infusing the promised working capital. Starner Aff. ¶ 38-39. In February, 2015, Defendant failed to make the first payment due on the Cognovit Note. Starner Aff. ¶ 41. By May 2015, Plaintiff learned Defendant was selling off trucks and trailers without utilizing the proceeds for the Companies. Starner Aff. ¶ 44. In June 2015, Plaintiff also learned Defendant had paid out over $140,000 in "management fees" to insiders. Starner Aff. ¶ 53. It became clear Defendant had obtained the Companies to raid them. On June 15, 2015, Defendant's Chief Financial Officer and Operations Manager – both principals of Defendant – quit their posts. Starner Aff. ¶ 57. In July 2015, Plaintiff foreclosed on his security interests in the Companies to stop the bleeding.[5] Plaintiff immediately put the Companies into receivership to ensure the orderly liquidation of the remaining assets. *Id.*

IV. LAW AND ANALYSIS

A. The Legal Standard

Defendant has stated the basic legal standard. But Defendant incorrectly asserts a lower burden should apply here because a cognovit note is involved. A lower burden is typically applied

[5] *In re Dissolution of Merchants 5 Star Ltd and Merchants 5 Star, Inc.;* Franklin County Common Pleas Court, Case No. 15-CVH07-6200 (Judge French); Starner Aff. ¶ 60.

due to the recognition that cognovit note judgments are usually taken without notice to the defendant. That is not the case here, however. Plaintiff notified Defendant he would seek judgment on the cognovit note weeks before filing his complaint. Ex. C - Caudill Aff. ¶ 29-38, filed herewith. Defendant also had time to seek leave to amend its Answer and raise its defenses between the filing of the complaint (October 13, 2015) and the entry of final judgment (October 22, 2015). The judgment taken here was not a true "cognovit" judgement in the typical sense. Defendant had time and opportunity to raise its defenses before the entry of judgment but did not.

Defendant has requested a hearing on its motion. The Court should grant a hearing to take evidence before it rules on the motion - but only when operative facts have been offered, which would warrant relief from judgment. *State ex rel. Richard v. Seidner*, 76 Ohio St.3d 149, 151, 1996-Ohio-54. If the Court grants a hearing, Plaintiff requests some pre-hearing discovery to develop additional evidence regarding Defendant's (1) pre-transaction fraud, (2) post-transaction fraudulent transfers and (3) bad faith in submitting its motion.

B. Defendant Cannot Prove Fraudulent Inducement.

Defendant supports its Rule 60(B) motion with two affidavits. James Pack's affidavit alleges misrepresentations and misconduct by Plaintiff. Defendant's Counsel's affidavit merely authenticates a letter from Defendant's Counsel to Plaintiff's Counsel. As a threshold matter, Pack fails to make averments with sufficient particularity to establish fraud. See *Allied Erecting & Dismantling Co. v. Ohio Edison Co*., 7th Dist. Mahoning No. 10-MA-25, 2011-Ohio-2627, ¶ 40. His affidavit fails to aver, even generally, that Plaintiff made any *knowing* or *reckless* misrepresentations - an essential element of fraudulent inducement. *See Id.* at ¶ 41. Furthermore, Pack fails to state the time and place of the alleged false representations with sufficient particularity. His affidavit only generally refers to "prior to the transaction."

1. The Purchase Agreement Disclaims the Representations Alleged by Pack.

Pack alleges he relied on *pre-transaction* misrepresentations involving the value of trailers. *Id.* *Justifiable* reliance is an essential element of fraudulent inducement. Pack's claimed reliance is not justifiable because the Purchase Agreement specifically disclaimed such representations.

Section 12.5 of the Purchase Agreement, captioned Entire Agreement, states:

> This Agreement, including any certificate, schedule, exhibit or other document delivered pursuant to its terms, constitutes the entire agreement between the parties. There are *no verbal agreements, representations, warranties, undertakings or agreements between the parties*, and this Agreement may not be amended or modified in any respect, except by a written instrument signed by the parties to this Agreement. (Emphasis added.)

Section 2.7 of the Purchase Agreement, captioned Title and Condition of Assets, is located in Article III – Representations and Warranties of Sellers. This Section states:

> Except as set forth on Schedule 2.7, the Companies own and possess all right, title and interest in and to their assets. *Sellers make no representation as to the same being (i) in good repair and operating condition, (ii) suitable for immediate use in the ordinary course of business, (iii) free from latent and patent defects, and (iv) not in need of maintenance or repairs.* Neither Shareholder nor the Companies has made any other agreement for the sale, lease or transfer of all or any part of the assets except in the ordinary course of business. (Emphasis added.)

Pack fails to state whether Plaintiff's alleged misrepresentations were verbal or written – he simply says "represented." But with the exception of a vague reference to "certain balance sheets," he clearly means verbal representations because he neither points to nor attaches any written representations. The Purchase Agreement, however, disclaims verbal representations.

2. The Parole Evidence Rule Bars Reliance on the Alleged Representations.

Pack alleges the "representations" were made "prior to the transaction. But the Purchase Agreement was an integrated agreement pursuant to Section 12.5. Permitting Defendant to rely on *pre-transaction* representations violates the parole evidence rule. While the parole evidence rule does not generally apply to fraud, the rule "may not be avoided by a fraudulent inducement claim which alleges that the inducement to sign the writing was a promise, the terms of which are

directly contradicted by the signed writing." *National/Rs, Inc. v. Huff*, 10th Dist. Franklin No. 10AP-306, 2010-Ohio-6530, ¶ 25. "An oral agreement cannot be enforced in preference to a signed writing which pertains to exactly the same subject matter." *Id.*

Pack's claims of verbal representations impermissibly contradict Section 12.5. Likewise, Pack's claim that the "book values" of the trailers were misrepresented based on their condition directly contradicts Section 2.7, which disclaims representations regarding the condition of assets. The parole evidence rule bars reliance on these "misrepresentations. Also, Defendant's attorney admitted any possible incorrect valuation of equipment "was done in error and not with purpose…." Onda Aff. ¶ 34, Ex. B-7. Defendant's allegation of fraud is disingenuous at best – a fraud on the Court at worst. Defendant has offered this in bad faith.

3. The Purchase Agreement Requires Misrepresentations to Be Treated as a Breach of Contract – Not Fraud.

Read together, the Purchase Agreement, Pack's allegations and Defendant's arguments describe a breach of contract – not fraud. As described above, the Purchase Agreement addressed representations and warranties. It disclaimed certain specific representations and provided contractual remedies for the "breach of, or misstatement in…" representations not specifically disclaimed. Purchase Agreement Section 5.2. Anticipating that disputes over representations might occur, the parties agreed they would be treated as contract issues – not fraud. Treating the alleged "breach" of representations as "fraud" directly contradicts Section 5.2.

By pointing to vague "asset values" contained on "certain balance sheets," Defendant tries to avoid Section 2.7 and shoehorn alleged representations concerning the condition of trailers into Sections 2.8 and 2.22 of the Purchase Agreement. Those sections are captioned Financial Statements and Material Misstatement or Omissions, respectively. Defendant argues Plaintiff's alleged inflation of trailers based on their condition made the financial statements required by

Section 2.8 misleading, thus resulting in a breach of Section 2.22's prohibition on "untrue statements of material fact…." Defendant then claims these "misrepresentations" survived beyond one year and are therefore actionable by operation of Section 5.1 of the Purchase Agreement, so long as Defendant provided timely notice. See Def. Ex. B-1.[6] Of course, this only further demonstrates that Defendant has asserted a breach of contract – not fraud.

4. Pack's Allegations are Vague, Conclusory and Lack Evidentiary Support.

Defendant conspicuously failed to attach those "certain balance sheets" to its motion. In truth, only one balance sheet was incorporated into the Purchase Agreement. Purchase Agreement Schedules, Document No. 20. By agreement of the parties and the express language of Section 2.8, that balance sheet was "unaudited" – in other words, Defendant accepted the balance sheet subject to its own due-diligence. *See* Purchase Agreement Section 2.8.

Pack's allegations regarding "inflated book values…for certain assets of Merchants 5 Star" are insufficient to support Defendant's motion because they are vague, conclusory, and lack evidentiary support. Neither the Court nor Plaintiff should have to guess what Pack means by "book values." This failure to provide *specific operative facts* undermines Defendant's motion. *See Mock Road Supermarket, Inc. v. MiraCit Development Corp*., 10th Dist. Franklin No. 10AP-913, 2011-Ohio-4594, ¶ 30 ("…the movant must allege operative facts with *enough specificity* to allow the trial court to decide whether he or she has met that test."). Although Pack refers to "assets," the only specific asset mentioned is "trailers." Pursuant to Section 2.7 of the Purchase Agreement, however, Defendant purchased the assets, including trailers, "as is."

5. The Fraud Allegations Concerning the UNB Loans Fail for Lack of Harm.

[6] Attorney Cole's letter does not mention the "misrepresentation" concerning OSHA compliance, which appears in Defendant's Rule 60(B) motion. By Defendant's own analysis, this "misrepresentation" did not survive the one-year expiration provision and is not actionable.

Pack's allegations regarding the status of the United Bank Loans are similarly vague, unsupported and fail to demonstrate Defendant suffered any harm. No written representations regarding the status of the United Bank Loans were incorporated into the Purchase Agreement nor has Pack pointed to any. Onda Aff. ¶ 21. Accordingly, Pack again relies on verbal representations. Pack claims the loans were "in technical default" and "were being reviewed by the workout department at the bank at the time of the Purchase Agreement transaction." But Pack doesn't explain what "technical default" means nor point to any evidence supporting this allegation. Pack speculatively claims "the likelihood of a default and deficiency judgment implicating the Guaranty was substantially higher than what Starner led me to believe." But United Bank never declared a default on the loans at any time. Starner Aff. ¶ 50; Ond Aff. ¶ 33; Ex. D - Robinson Aff., ¶ 8-9 filed herewith. Pack's speculative allegation never came to pass. Defendant can never prove any injury proximately caused by a "technical default" or a *real* default because none ever occurred. Defendant cannot prove this essential element of fraud.

6. There Is No Fraud Where the True Facts Were Open to Defendant.

Parties cannot allege an action for fraud where the true facts are equally open to both parties. *See Kovacic v. All States Freight Sys.*, Cuyahoga App. No. 69926, 1996 Ohio App. LEXIS 3474 (August 15, 1996); *see also LaVeck v. Al's Mustang Stable*, 73 Ohio App. 3d 700, 598 N.E.2d 154 (11th Dist. 1991). Schedule 2.7 of the Purchase Agreement (relating to Title to and condition of assets) contains every serial number for every truck and trailer and specifically states: "This information has been previously provided and reviewed by Purchaser." Defendant inspected the assets before the transaction was executed and knew the condition of the trucks and trailers. Starner Aff. ¶ 34.

Similarly, Defendants were provided with the account numbers for all of the United Bank

loans.[7] Defendants could have easily verified the status of the loans. Robinson Aff., ¶ 12-13. Last, Defendants could have easily verified the alleged representations regarding OSHA compliance. Not surprisingly, Pack doesn't provide any specifics regarding OSHA deficiencies in his affidavit – his vague allegations simply refer to "recommendations" he claims were never implemented. Defendant could have contacted the OSHA consultant, confirmed his recommendations and verified they had been implemented.[8]

Defendant's sophistication, training and experience should be taken into account here. Pack was experienced at buying trucking companies and actively marketed himself as a "turn-around" expert. Starner Aff. ¶ 8-9. Indeed, only a few years earlier, Pack had purchased another family-owned trucking company, KBT Freight, Inc. (which Plaintiff later learned Pack similarly ran into the ground). See *In re: KBT Freight, Inc.*, Southern District of Ohio Bankruptcy Court, Case No. 2:12-bk-51683. Defendant was also represented by its attorney, Ben MacDowell, and its investment banker, Neil Johnson. Starner Aff. ¶ 17-31. Pack, MacDowell and Johnson conducted a thorough analysis of the Companies and their assets and obligations prior to the transaction and had ample opportunity to verify the truth of representations contained in any schedules or disclosures. Starner Aff. ¶ 22.

In truth, MacDowell actually instructed Plaintiff's attorney, Robert Onda, to keep schedules and disclosures to a minimum. Onda Aff. ¶ 15. In a hurry to close the deal, MacDowell communicated the following:

> I know that you have not been involved since day 1; but buyer has not received comments to its initial draft agreement that was initially provided to your client on 6/4 and this process is taking quite a long time. Both buyer and seller are ready to move forward and they have been having near daily conference calls regarding

[7] The United Bank loans were detailed in Schedule 3.4 of the Purchase Agreement and also attached to the Purchase Agreement Schedules as Documents No. 6 and 7. Starner Aff. ¶ 35-36.

[8] As pointed out in an earlier section, the OSHA issue was never raised prior to Defendant's Rule 60 motion – suggesting that it is yet another sham defense.

> operation of the business. With Buyer's involvement and understanding of the business, there is nothing from buyer's perspective that could be produced to fill-out the schedules or that will surprise buyer post-closing to change the deal and the buyer is willing to shift schedule/disclosure risk to the buyer to move this forward in an attempt to prevent further delay in closing this transaction. *See* Ex. B-1.

Defendant didn't care about representations because Defendant knew the business and knew what it was buying. This is further evidence Defendant's motion was made in bad faith.

C. Post-Transaction Misconduct is Not a Defense to a Cognovit Judgment.

Cognovit notes, by definition, "cut off every defense, except payment, which the maker of the note may have against enforcement of the note." *Shuford v. Owens*, 10th Dist. Franklin No. 07AP-1068, 2008-Ohio-6220, ¶18. Although the defense of non-default "is not the only meritorious defense recognized by courts as being available to a cognovit judgment debtor seeking Civ.R. 60(B) relief, 'a judgment on a cognovit note generally will not be vacated for reasons which do not encompass such matters of integrity and validity.'" *Id*., (quoting *First Merit Bank v. NEBS Financial Servs., Inc*., 8th Dist. Cuyahoga No. 87632, 2006-Ohio-5260, ¶18).

Defendant's defenses based on *post-transaction* "misconduct" alleges in substance (a) Plaintiff breached his Employment Agreement or (b) Plaintiff breached his fiduciary duty. In Defendant's Exhibit B-1, under the headings Breach of Contract and Breach of Fiduciary Duty, Defendant's Counsel refers to the same allegations of misconduct raised in Defendant's motion. But breach of contract is not a meritorious defense to a cognovit note judgment. *Mock Road Supermarket, Inc., supra* at ¶¶ 14, 22. Breach of contract is the type of defense that a party inherently waives when it signs a cognovit note. In *Mock*, the 10th District pointed out that the cognovit note contained the following language:

> BY SIGNING THIS PAPER YOU GIVE UP YOUR RIGHT TO NOTICE AND COURT TRIAL * * * REGARDLESS OF ANY CLAIMS YOU MAY HAVE AGAINST THE CREDITOR WHETHER FOR RETURNED GOODS, FAULTY GOODS, FAILURE ON HIS PART TO COMPLY WITH THE AGREEMENT, OR ANY OTHER CAUSE.

The *Mock* court explained this language eradicated any possible defenses for nonpayment including, but not limited to, appellee's failure to comply with the parties' agreement.

The cognovit note in this case contains near identical language:

> WARNING – BY SIGNING THIS PAPER YOU GIVE UP YOUR RIGHT TO NOTICE AND COURT TRIAL. IF YOU DO NOT PAY ON TIME A COURT JUDGMENT MAY BE TAKEN AGAINST YOU WITHOUT YOUR PRIOR KNOWLEDGE AND THE POWERS OF A COURT CAN BE USED TO COLLECT FROM YOU REGARDLESS OF ANY CLAIMS YOU MAY HAVE AGAINST THE CREDITOR WHETHER FOR RETURNED GOODS, FAULTY GOODS, FAILURE ON HIS PART TO COMPLY WITH THE AGREEMENT, OR ANY OTHER CAUSE.

Similarly, breach of fiduciary duty is also not a meritorious defense to a cognovit note judgment. See *K One L.P. v. Khan*, 10th Dist. Franklin No. 13AP-830, 2014-Ohio-2079 (citing *Ohio Carpenter's Pension Fund v. La Centre, L.L.C.*, 8th Dist. Cuyahoga No. 86597, 2006-Ohio-2214).

Defendant cites to Virginia and Michigan cases to support the proposition that one causing a breach of an agreement should not benefit from the agreement. But those cases don't involve cognovit note judgments. In Ohio, alleged misconduct unrelated to the integrity or validity of the note is not a meritorious defense to cognovit note judgments.

Last, Defendant asserts it has a counterclaim against Plaintiff for breach of the Employment Agreement. But Defendant failed to raise that compulsory counterclaim in two prior actions concerning the Employment Agreement; thus the counterclaim is barred.[9] Furthermore, Defendant lacks standing to bring that counterclaim. That agreement was between Plaintiff and Merchants 5 Star, Ltd – not Defendant. Merchants 5 Star Ltd is in receivership - only the Receiver has standing.

D. Merchant's Fraud and Misconduct Defenses Are Barred by Res Judicata.

Defendant failed to pay the Companies' debts, so creditors sued Defendant, the Companies

[9] Discussed in further detail below.

and Plaintiff.[10] Plaintiff filed third-party and cross claims for indemnification against Defendant in those cases. Plaintiff's claims were grounded in the Purchase Agreement, which Plaintiff attached in support. Defendant refused to file an answer or counterclaim to Plaintiff's third party claim in the *Leverity* case and a default judgment was entered on November 19, 2015.[11] Similarly, Defendant refused to file an answer or counterclaim to Plaintiff's cross-claim in the *Bates* case.[12]

Furthermore, Defendant willingly submitted to a Final Agreed Judgment Entry in the *Bates* case, in *full satisfaction* of Bates' prayer for relief. The Bates' debt arose from the Purchase Agreement Defendant now claims it was "fraudulently induced" into entering. Caudill Aff. ¶ 11. In *Bates*, where Plaintiff was a co-defendant, Defendant agreed it was legally bound by the Purchase Agreement. Defendant should not be permitted to escape the Purchase Agreement now.

The default judgments also decided the issue of Plaintiff's performance under the Purchase Agreement. Plaintiff submitted identical affidavits in support of his default motions in both of the prior cases. Therein, Plaintiff testified: "I performed my obligations under the Purchase Agreement." In *Leverity*, Plaintiff provided Defendant with the filed motion and Plaintiff's supporting affidavit prior to the entry of default judgment. Defendant offered no objection instead stating unequivocally it did not oppose default judgment. Caudill Aff. ¶ 19-20.

E. Defendant Does Not Have a Meritorious Defense Based on Partial Payment

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[10] See *Leverity v. Merchants 5 Star Ltd et al*, Cuyahoga County Common Pleas Court, Case No. CV-15-847302 (Judge Russo); and, *Bates v. Merchants Holding LLC et al*, Franklin County Common Pleas Court, Case No. 15-CV-006657 (Judge Frye).

[11] Defendant never intended to defend itself in those cases. Defendant submitted to a Final Agreed Judgment Entry in *Bates* in full satisfaction of Bates' prayer for relief without ever filing an Answer. Concerned about the res judicata effect of the default judgments, however, Defendant approached Plaintiff and offered to "submit" to default judgments on Plaintiff's third party and cross claims if Defendant could reserve its defenses and counterclaims for later. Defendant and Plaintiff initially discussed settlement but never came to an agreement. Plaintiff specifically rejected Defendant's attempt to reserve its defenses and counterclaims. Because settlement discussions had taken place, Plaintiff waited 23 days before filing a motion for default judgment in *Leverity* and 28 days in *Bates*, so Defendant could seek leave to file a late answer. To ensure there was no misunderstanding, Plaintiff informed Defendant he removed all references to "unopposed" in the default motion, since no settlement was reached. Plaintiff explains this situation and provides the pertinent correspondence with Defendant in Plaintiff's Counsel's affidavit.

[12] Plaintiff's motion for default judgment in *Bates* is pending before Judge Frye.

Pack alleges Defendant made a partial payment on March 10, 2015. This is false. On March 19, 2015, Defendant's General Counsel, MacDowell, admitted that Defendant had not made any payments to Plaintiff under the promissory note. Onda Aff. ¶ 35, Ex. B-7. Again, Defendant has offered this defense in bad faith.

In any event, a partial payment does not support setting aside the entire judgment. When the only operative facts raising a meritorious defense are those related to partial payment, the trial court should consider only the amount due – not the validity of the note itself. See *Sadraoui v. Hersi*, 10th Dist. 10AP-849, 2011-Ohio-3160.

F. Defendant Should Not Be Permitted to Come Into Equity With Unclean Hands.

"He who comes into equity must come with clean hands." *Kinner v. Lake Shore & Michigan S. Ry. Co.*, 69 Ohio St. 339, 69 N.E. 614 (1904). Defendant obtained the Companies fraudulently - representing it had money it did not have. Section 3.3 of the Purchase Agreement:

> Immediately after Closing and for the one year subsequent to Closing, Purchaser shall contribute working capital to the Companies to ensure their continued viability. The parties contemplate that Purchaser shall need to contribute approximately $350,000-$500,000 to the Companies.

Defendant has admitted it never had the promised working capital. Onda Aff. ¶ 37. To stall discovery of this fact, Defendant arranged a sham "loan" of somewhere between $150,000 and $175,000 from 1212 Capital LLC – a company owned by Defendant's CFO and principal, Neil Johnson. Onda Aff. ¶ 38. The loan was a sham because Defendant paid out (1) $140,000 in "management fees" to its principals, including Johnson; (2) $19,570 to Johnson's American Express Card; and, (3) $33,530 back to 1212 Capital while the Companies were struggling. Starner Aff. ¶ 53-56. Furthering the fraud, Defendant permitted 1212 Capital LLC to take a lien on "all" of Defendant's assets. Onda Aff. ¶ 41; Caudill Aff. ¶ 39, Ex. C-2. 1212 Capital LLC is now

attempting to "recoup" its sham loan from the receivership estate by asserting its fraudulently transferred lien rights.[13]

Even with 1212 Capital LLC's sham "loan," Defendant never contributed close to the $350,000 to $500,000 promised. Onda Aff. ¶ 32, 37, 41. Defendant asserts the Cognovit Note was to be paid "from the operating revenues generated by [Defendant's] ownership of Merchants 5 Star." Def. Mot. p. 3. If this is true, Defendant frustrated that purpose by failing to contribute the critically-needed working capital;[14] fraudulently transferring $140,000 as "management fees" to insiders, while at the same time claiming the Companies were "insolvent;" and, selling the Companies most valuable assets without returning the proceeds to the Companies. To put it in perspective, Defendant's 6 months of delinquent payments on the Cognovit Note prior to the Receiver taking over equaled only $12,000 (6 x $2,000). Defendant's fraudulent payments to insiders totaled nearly $190,000.

The Court should deny Defendant equitable relief due to its fraud. This is true even if Defendant could prove Plaintiff also did anything wrong, which Defendant cannot. See *Birr v. Birr*, 6th Dist. No. F-10-021, 2012-Ohio-187. In *Birr*, the appellate court upheld a decision overruling a Rule 60 motion that challenged an order of separation, even while finding that the party opposing the motion also had unclean hands. *Birr* explained: "Equity is based upon what is perceived as just under the circumstances of each case and, when both parties are guilty of injustice, a court of equity will leave them as they are." Plaintiff did nothing wrong in this matter, but even if he did, Defendant's own fraud is a complete bar to relief.

[13] *In re Dissolution of Merchants 5 Star Ltd and Merchants 5 Star, Inc.;* Franklin County Common Pleas Court, Case No. 15-CVH07-6200 (Judge French), First Report of Receiver, filed September 29, 2015.

[14] Plaintiff asserts Defendant's failure to contribute working capital as required by Section 3.3 of the Purchase agreement is a breach of Defendant's representations and warranties. But Defendant's assurance that it had the required working capital prior to, and at signing, was fraud.

V. CONCLUSION

Defendant's motion is frivolous and offered in bad faith. When submitted, Defendant knew: (1) the Purchase Agreement specifically disclaimed verbal representations and representations concerning the condition of assets; (2) Any incorrect valuations of assets were simple error – not fraud; (3) the Purchase Agreement treats misrepresentations as contract breaches – not fraud; (4) Defendant expressly assumed the disclosure risk; (5) Defendant never had or contributed the working capital required by the Purchase Agreement; (6) Defendant never suffered harm from defaulted UNB loans because UNB never declared a default; (7) Defendant never made a payment on the Cognovit Note; and, (8) Defendant's fraudulent transfers to insiders prevented it from paying the Cognovit Note. Furthermore, it is black-letter law that breach of contract, breach of fiduciary duty and other *post-transaction* conduct are not meritorious defenses to cognovit note judgments. Last, Defendant could have raised its fraud and misconduct defenses in *Leverity* and *Bates*. And Defendant could have sought leave to amend its answer prior to the entry of final judgment in this case. Defendant didn't do either. Instead, Defendant forced Plaintiff to spend a substantial amount of time and effort responding to these sham defenses. Defendant's motion should be denied.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that a true and accurate copy of the foregoing document was served upon counsel for Defendant via the Court's electronic filing system on January 4, 2016.

/s/ Danny L. Caudill

Danny L. Caudill (0078859)
Counsel for Plaintiff Jeffrey Starner