COURT OF APPEALS OF WISCONSIN
DISTRICT I
Appeal No. 2015AP207

SCOTT SMITH,

Plaintiff-Respondent-
Cross-Appellant,

ALPHA CARGO TECHNOLOGY, LLC,

Plaintiff,

v.

GREG KLEYNERMAN,

Defendant-Appellant-
Cross-Respondent,

RED FLAG CARGO SECURITY SYSTEMS, LLC,

Defendant.

Appeal from the Circuit Court for Milwaukee County
Honorable Pedro Colon, Presiding
Case No. 2011CV18551

BRIEF OF APPELLANT GREG KLEYNERMAN

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STATEMENT OF THE ISSUES

The issues in this case arise from a transaction in which a Wisconsin limited liability company (LLC), of which Greg Kleynerman and Scott Smith were equal 50% members, sold all its assets—patents and related rights—to a third party buyer and became the buyer's sales representative. Both Kleynerman and Smith ratified the transaction. More than two years after the transaction, Smith sued Kleynerman, asserting (in the only claim upon which the judgment is based) breach of fiduciary duty in connection with the transaction.

I. Did Kleynerman, under the facts established at trial, owe Smith a fiduciary duty to further Smith's personal interest in the transaction?

II. If there was such a fiduciary duty, was there sufficient evidence at trial to support the verdict that Kleynerman breached it?

III. Was Smith's breach of fiduciary duty claim, brought 30 months after the transaction closed, timely under the (then) two-year statute of limitations of Wis. Stat. § 893.57?

IV. Did Smith, as a member of the LLC, have standing to recover damages suffered by the LLC?

V. Was there competent evidence at trial to sustain the jury's award to Smith of damages for breach of fiduciary duty?

In denying the motions after verdict, the circuit court implicitly answered all these issues in the affirmative, though it did not address any of them directly.

STATEMENT ON ORAL ARGUMENT AND PUBLICATION

Oral argument and publication are warranted. Wis. Stat. §§ 809.23(1)(a)1.&5., 809.22(2). The circuit court's decision demonstrates that the principles governing the duties of LLC members to each other are in need of further development. And the appeal raises several other important issues on fiduciary duties, standing, and damages. The case presents one of the first opportunities for this Court to interpret the amendments to Wis. Stat. § 907.02 on admissibility of expert testimony. A published

opinion would help clarify these issues, and the Court would benefit from oral argument as it decides them.

STATEMENT OF THE CASE

Smith filed this lawsuit in December 2011, asserting that he had been mentally incompetent in June 2009 when he signed agreements by which his and Kleynerman's struggling company had sold its only assets and became a sales representative of the buyer. The primary claim, against the buyer, sought rescission on that ground. Smith's alleged mental incompetence also colored each of the several other claims that he asserted, including a claim for breach of fiduciary duty against Kleynerman.

At trial, the jury observed Smith, listened to the evidence, and returned a verdict against him on his rescission claim, rejecting his incompetence assertion. Smith—concentrating on that assertion—introduced *no* evidence of damages for his breach of fiduciary duty claim; his damages expert expressly did not opine on such damages. The jury nevertheless decided that Kleynerman had breached a fiduciary

duty to Smith and awarded him $499,000 in compensatory damages.

The circuit court denied Kleynerman's post-trial motion for directed verdict, which contended that the breach of fiduciary duty claim was deficient as a matter of law and that the damages award was not supported by competent evidence. In sustaining the verdict, the court declined to address the legal issues that Kleynerman raised.

Nature of the Case

Alpha Cargo Technology, LLC (ACT), a Wisconsin LLC, sold its patents and related materials (its only assets) to Red Flag Cargo Security Systems LLC (Red Flag) in June 2009 and became a sales representative of Red Flag. Kleynerman and Smith, as the only members of ACT (each holding a 50% interest), consented to the transaction. Nevertheless, two-and-one-half years later, in December 2011, Smith sued Kleynerman in a ten-count complaint. Smith sued in his own right and also purported to sue on behalf of ACT; he also named Red Flag as a defendant.

Primarily, Smith sought to rescind the transaction, claiming that he was mentally incompetent when he signed the agreements. Smith abandoned almost all his claims at trial. Only three of them went to the jury—rescission (by ACT against Red Flag), misrepresentation (by Smith against Kleynerman), and breach of fiduciary duty (by Smith against Kleynerman).

The jury returned a verdict in favor of Kleynerman and Red Flag on the rescission and misrepresentation claims and against Kleynerman for breach of fiduciary duty. The jury awarded Smith $499,000 in compensatory damages, even though by the opening of trial Smith was seeking just $175,000 for misrepresentation. The jury also awarded $200,000 in punitive damages, which the trial court struck.

The viability of the judgment against Kleynerman entered on the verdict depends on the Court's answering all of the questions presented in Smith's favor. Does a fiduciary duty between LLC members arise on the facts presented at trial; if so, was there a breach of that duty: was the claim timely brought;

did Smith have standing to recover the damages he claimed; and was any competent evidence presented to support the damages award? A "no" answer to *any* of these questions requires reversal and the entry of judgment in Kleynerman's favor.

Statement of Facts

There were two principal areas of competing evidence presented at trial: whether Smith was mentally incompetent when ACT entered into the 2009 transaction and whether Kleynerman made false statements of fact to Smith concerning the transaction. Both of these factual disputes were decided against Smith. The facts relevant to the breach of fiduciary duty claim, described below, were largely undisputed.

I. THE PARTIES

A. Greg Kleynerman

Greg Kleynerman immigrated to the United States from Ukraine, with his family, 25 years ago. (R.153, 9/25/14 Tr. at 229:12-32:25.) He had studied engineering in Ukraine for three years in the late 1980s but did not finish his studies and did not get a college degree. (*Id.* at 231:8-32:4.) Upon arrival in

Milwaukee, Kleynerman began working as a tailor and soon bought a tailor shop and later a dry cleaning business. (*Id.* at 233:6-34:10.)

When the post-Soviet markets opened up to foreign investments in the early 1990s, Kleynerman saw an opportunity there, sold his dry cleaning business, and began to import consumer goods (mainly shoes and clothing) into Russia. (R.153, 9/25/14 Tr. at 234:14-35:22.) After the 1998 collapse of the Russian currency, Kleynerman's consumer goods importing business suffered, and he began to look into new business opportunities. (*Id.* at 236:3-18.) One such opportunity was to sell cargo security seals to Russian businesses that had the need for these products.[1] (*Id.*) In looking for a supplier of cargo security seals, Kleynerman met Scott Smith. (*Id.* at 237:3-6.)

B. Scott Smith

Scott Smith is Kleynerman's contemporary and lives in Minneapolis. He is widowed; his wife of 20 years died in 2007

[1] Cargo security seals are locks used on cargo containers to prevent theft.

after being diagnosed with lung cancer that year. (R.150, 9/22/14 Tr. at 164:6.) Smith graduated from the University of Wisconsin-Green Bay with a degree in Spanish and International Business. (*Id.* at 135:19-21.) Smith also has a Master's Degree from the American Graduate School of International Management. (*Id.* at 136:12-16.). When Kleynerman met Smith in the late 1990s, Smith worked for a cargo security seal manufacturer. (*Id.* at 138:4-10).

II. KLEYNERMAN'S AND SMITH'S CARGO SECURITY SEAL BUSINESSES

A. Smith and Kleynerman Form ACT

Shortly after Kleynerman met Smith, they set up their own company (with a third partner) to distribute cargo security seals in Europe. (R.153, 9/25/14 Tr. at 238:12-39:25.) That company was called Alpha Technology International (ATI). (*Id.* at 238:15.) After a couple of years of modest sales, ATI was closed because of a disagreement between Smith and the third partner. (*Id.* at 240:15-42:19.)

Smith and Kleynerman then formed ACT in 2002, to distribute cargo security seals in the United States. (*Id.* at 241:22-44:17.) ACT was organized as a Wisconsin limited liability company (R.139, Def. Ex. 1.); Kleynerman and Smith each had a 50% membership interest. (R.1, Complaint ¶8.) ACT had no employees, no offices, and no manufacturing facilities. (R.154, 9/26/14 Tr. at 27:20-25.) Kleynerman and Smith ran ACT out of their homes in Milwaukee and Minneapolis, respectively. (*Id.*) ACT bought cargo security seals made by Chinese and European manufacturers and resold them to ACT's customers in the Americas. (R.153, 9/25/14 Tr. at 254:17-55:23; R.139, DX[2] 180.) ACT's main supplier was a Ukrainian manufacturer called VTP (R.153, 9/25/14 Tr. at 243:19-21), whose management and engineering staff Kleynerman knew well. (*Id.* at 243:15-44:17.)

In the late 1990s-early 2000s, Kleynerman worked with VTP's engineers in Ukraine on the locking mechanism of a

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[2] Citations to DX and PX are to defendants' trial exhibits and plaintiffs' trial exhibits, respectively.

cargo security seal and contributed to certain inventions that were made in that collaborative process. (*Id.* at 246:11-51:13.) Kleynerman and Smith believed that if the seals that ACT was selling were patented in the United States, ACT would sell more of them. Therefore, ACT filed three patent applications in the United States on the locking mechanism inventions that resulted from Kleynerman's work with VTP's engineers. (R.139, DX 179.) Kleynerman was listed as one of the inventors, and the inventors assigned the issued U.S. patents to ACT. (*Id.*)

B. ACT Fails to Achieve Financial Success

Kleynerman and Smith divided their responsibilities in ACT. Because of his relationships with the Ukrainian manufacturer and knowledge of the technology, Kleynerman was responsible for the "technical" aspects, such as receipt of products in the United States, storage (in his garage), packaging, and shipment of products to the customers. (R.154, 9/26/14 Tr. at 24:21-25:16.) Smith, because of his presence on the boards of various trade organizations in cargo security industry, was responsible for marketing and sales. (*Id.*)

ACT struggled financially at all times. The following chart lists ACT's revenues and net income (loss) between 2003 and 2008:

Year	ACT's Revenue	Net Income/(Loss)
2003 (R.139, DX2)	$18,856	($4,199)
2004 (R.139, DX3)	$23,677	$2,910
2005 (R.139, DX4)	$112,723	($115,639)
2006 (R.139, DX5)	$680,187[3]	$289,423
2007 (R.139, DX6)	$475,813	$175,221
2008 (R.139, DX7)	$56,428	($4,571)

As the worldwide economy was collapsing throughout 2008 and early 2009, it was evident to Smith and Kleynerman that they could no longer operate ACT as before. Their business model of buying cargo security seals made by third parties outside the United States, importing them into this country, and

[3] ACT's only large order came from Cemex, a cement manufacturer located in Mexico. In 2007, Cemex ceased ordering ACT seals. (R.151, 9/23/14 Tr. at 192:10-94:5, 190:25-91:2.)

then re-selling them overseas was not working. (R.154, 9/26/14 Tr. at 31:19-34:2, R.139, DX 13.) Smith and Kleynerman discussed different options, including closing ACT and getting new jobs. (R.154, 9/26/14 Tr. at 34:11-14, 52:8-13.) Smith suggested that ACT start buying Chinese seals to sell on the internet. (R.139, DX 14, A.App.135; R.154, 9/26/14 Tr. at 42:12-44:16.) Kleynerman did not think that this model would work because ACT did not have money to prepay for the products, to advertise, or to front shipping costs. (R.154, 9/26/14 Tr. at 44:9-45:25.) Besides, Kleynerman had no money to invest in this operation, and Smith was not willing to invest any of his personal funds. (*Id.* at 44:17-20.)

Instead, Kleynerman suggested, and Smith agreed, that the only way for them to continue in this business was to find investors who would build a manufacturing facility in Milwaukee to produce the seals in the United States, to have an inventory on hand, and then to sell them from the existing inventory. (*Id.* at 46:6-17.)

C. Kleynerman Finds Investors to Allow ACT to Survive

In late 2008 and early 2009, as ACT was struggling for survival, Kleynerman began to discuss ACT and the business of cargo security seals with Bruce Glaser. (R.152, 9/24/14 Tr. at 176:4-25.) Glaser is a Milwaukee attorney and CPA who has been investing in local Milwaukee businesses for the last 20 years. (*Id.* at 173:12-17.)

After Kleynerman told Glaser about the cargo security seal industry, the products ACT was distributing, and the financial difficulties that ACT had, Glaser became interested in investing. (*Id.* at 178:18-179:2.) Glaser understood that an investment was needed to build a manufacturing facility in Milwaukee to produce the seals but Glaser did not want to become an investor *in ACT*. (*Id.* at 179:11-24.) Glaser did not know enough about ACT's liabilities and in any event wanted a new company that he could control. (*Id.*) Glaser also understood that construction of a manufacturing facility and purchase of machinery would require capital investment that Glaser was not

willing to finance solely on his own. (*Id.*) So, Kleynerman convinced his old friend, Greg Grinberg, who had previously lent money to ACT for operations, to invest alongside Glaser. (*Id.* at 180:11-16.) Grinberg agreed, and Glaser proceeded with the transaction.

III. GLASER, KLEYNERMAN, AND SMITH NEGOTIATE A TRANSACTION BY WHICH ACT SELLS ITS PATENTS TO GLASER'S NEW COMPANY AND BECOMES ITS SALE REPRESENTATIVE

A. Glaser Forms Red Flag

Glaser set up two separate Wisconsin limited liability companies for this transaction, one to be responsible for production and the other for sales. (*Id.* at 180:21-83:24.) The "production" company was named "Capitol Cargo Security LLC" (later renamed "Alpha Cargo Technology Production LLC" and later "Red Flag Production LLC") (R.139, DXs 41 and 43), and the "sales" company was named Alpha Cargo Technology Marketing LLC (later renamed "Red Flag Cargo Security Systems, LLC" (R.139, DX 40 and 42; R.152, 9/24/14 Tr. at 181-3). Glaser became a 75% owner of each company and Grinberg became a

25% owner of each, reflecting each party's agreement to pay for the necessary production facility, equipment, and machinery. (R.152, 9/24/14 Tr. at 183:2-84:5.)

B. Memorandum of Understanding Between ACT and Red Flag

In March, 2009, Glaser prepared and presented Kleynerman and Smith with a Memorandum of Understanding (MOU) that described the terms of a potential transaction between Red Flag and ACT. (R.139, DXs 55, 192; R.152, 9/24/14 Tr. at 184:22-85:6.) The very first draft of the MOU clearly provided that ACT was selling its patents to Red Flag and that ACT was going to become Red Flag's sales representative for an initial term of one year. (R.139, DX 55.) Smith commented on the draft MOU and sought an increase in the consideration that Red Flag was to pay ACT for the patents. (*E.g.*, R.152, 9/24/14 Tr. at 188:6-16.)

After the terms of the proposed transaction were agreed upon, Smith, Kleynerman, and Glaser met in Milwaukee, again reviewed the terms, and signed the MOU. (R.139, DX 56,

A.App.140; R.152, 9/24/14 Tr. at 189:6-190:2.) The MOU provided that Red Flag was to pay ACT $45,000[4] for the patents if ACT made no sales or up to $70,000 if ACT made sales, at the rate of $0.05 for each seal sold. (R.139, DX 56, A.App.140.) In addition, as a sales representative of Red Flag, ACT would be paid a commission equal to 50% of gross profit on each seal sold. (*Id.*)

The MOU also contained a provision entitled "Authorization to Negotiate and Sign Documents," which authorized Kleynerman, on behalf of ACT, to sign documents that would "assign all patents, the website, and logo to [Red Flag]." (*Id.*) This provision allowed Kleynerman to sign on behalf of ACT various ancillary documents (patent assignments, trademark assignments) that might have to be filed with the various

[4] ACT owed this sum to its patent counsel. (R.154, 9/26/14 Tr. at 86:22-25; R.139, DX 189.)

recording offices once the asset sale agreement was signed.[5] (R.152, Tr. 9/24/14 at 193:2-195:14.)

C. ACT and Red Flag Negotiate and Sign the Asset Sale Agreement and the Sales Representative Agreement

After the MOU was signed, Glaser's counsel prepared drafts of the transactional documents described in the MOU. (R.152, 9/24/14 Tr. at 195:18-96:20.) On April 24, 2009, Glaser sent Smith and Kleynerman drafts of these documents. (R.139, DX 57, A.App.142.) Glaser and Smith (on behalf of ACT) engaged in much back-and-forth negotiation of these documents by email and phone. (R.139, DX 60.) Kleynerman did not make any comments on the drafts. (*E.g.*, R.139, DXs 58-59, A.App.143-44.) On May 11, 2009, in commenting on the draft patent assignment forms, Smith acknowledged that Kleynerman was listed as signatory on behalf of ACT and wrote only that *if* Smith's signature, too, was necessary on this document, his name should

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5 *See generally* USPTO, "FAQs," http://www.uspto.gov/learning-and-resources/transferring-ownership-assignments-faqs ("What does it mean when a document is " recorded ?").

be added. (R.139, DX 59, A.App.144, 148.) On May 22, 2009, Glaser sent Smith and Kleynerman revised clean drafts of the agreements and redlines showing changes to prior drafts requested by Smith. (R.139, DX 62, A.App.151.) Later that afternoon, Smith responded that he was ready to sign the documents. (*Id.* at. A.App.152, 5/22/09 2:27 p.m. email.)

The next day, however, Smith identified to Glaser an additional change: Smith wanted to retain for *himself* ACT's web address. (*Id.* at A.App.153, 5/23/09 2:51 p.m. email.) Smith reasoned that "if I am moved out of the equation for whatever reason," it "will be an undue hardship for me to move consulting customers to a new site." (*Id.*)[6]

A few days later, Smith again told Glaser why he wanted to retain the website address for himself. (R.139, DX 63, A.App.155-6, 5/26/09 6:46 p.m. email.) He wrote:

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[6] In addition to his involvement in ACT, Smith was operating his own cargo security consulting business at this time, called Harrison Consulting. (R.151, 9/23/14 Tr. at 75:12-15.)

> I am still concerned what can happen a year from now. Once this deal is signed I have nothing. *If I am pushed out a year from now and am forced to rely on nothing more than the consulting side of the business*, I will have to start over from a position of weakness trying to move my contacts to a new site, etc. Since you are not buying Alpha Cargo Technology, I wrongly assumed that you would only get selected content from the website. As it is now stated, you will own everything except the name and I guess I need to work that through. I realize everyone is under a time crunch to get this resolved and get it out of the way but I am working from a position of weakness. I was not involved in the back story, discussions, or ongoing conversations about the offer, etc so it is tough for me to see how this is a good deal for both of us. Let's discuss tomorrow if you have time.

(*Id.*) (emphasis added). Smith recognized that Glaser, as the owner of Red Flag, could terminate ACT as a sales representative after one year and not do business with Smith. Thus, Smith was hedging against that risk by seeking to retain for himself the ACT web address. (*Id.*) Glaser was hesitant to agree to this last-minute change that was inconsistent with the MOU, but, after Kleynerman backed Smith on this point, Glaser gave in. (R.152, 9/24/14 Tr. at 200:2-18.)

On June 4, 2009, Glaser agreed to the last change proposed by Smith, and the two exchanged a number of emails discussing the transaction and the opportunities ahead. (R.139, DX 65.) Later that day, Glaser emailed the revised drafts of the deal documents. (R.139, DX 66.) Smith responded in the morning on June 5, 2009 that he had signed the documents and would be mailing them to Glaser. (*Id.*) Indeed, Smith signed both the Asset Sale Agreement and the Sale Representative Agreement, not once but twice, in his capacity as a 50% member of ACT and also on behalf of ACT as its President. (R.139, DXs. 67 and 68, A.App.159-76.) Kleynerman countersigned these documents only after Glaser received the signed copies from Smith. (R.154, 9/26/14 Tr. at 60:17-21.)

D. After the Sale of Patents to Red Flag, Kleynerman Concentrates His Efforts on Establishing Manufacturing Capabilities While Smith Concentrates on Marketing and Sales

After the Asset Sale Agreement and the Sales Representative Agreement were signed in June 2009, Red Flag located factory space in Milwaukee for production and began to

buy necessary equipment, tools, and software to make cargo security seals. (R.152, 9/24/14 Tr. at 211:7-23.) Since Kleynerman's expertise was in manufacturing and software related to the seals, Kleynerman worked with Glaser to establish Red Flag's manufacturing capabilities and to improve the design and functions of cargo security seals that Red Flag would produce in Milwaukee. (*Id.* at 252:20-23.) Glaser also brought in a branding consultant and an experienced sales professional to help with marketing and sales. Since Smith touted his positions on various industry boards and his sales ability, Red Flag looked to Smith to lead the sales efforts. (*Id.* at 192:21-93:1, 212:6-10.)

As Glaser spent more time with Smith, however, Glaser became increasingly concerned with Smith's efforts and lack of responsiveness. (*Id.* at 212:11-17.) Glaser's consultant, too, concluded that Smith was not a strong salesman. (R.153, 9/25/14 Tr. at 220:7-10.) In short, during the year following the sale of the patents to Red Flag, ACT, as a sales representative, did not generate any meaningful sales. (*Id.* at 220:13-21:11.)

E. Red Flag Terminates ACT as a Sales Representative After Smith Misses a Sales Meeting and Fails to Maintain ACT's Public Filings

In April 2010, Red Flag and ACT were scheduled to pitch Red Flag's cargo security seals to the representatives of Kansas City Southern Railroad (KCSR) in Mexico. (R.152, 9/24/14 Tr. at 214:12-25.) This sales meeting was important because KCSR was looking to place a large order for security seals to protect the railcars in which GM vehicles were being transported from Mexico to the United States. (*Id.*; R.154, 9/26/14 Tr. at 78:17-25.) Kleynerman and Smith were to attend the meeting in person, Kleynerman to explain the technical capabilities of Red Flag's cargo security seals, and Smith to make the sales pitch and to serve as a translator. (R.152, 9/24/14 Tr. at 215:7-11.) Much to Glaser's dismay, on the evening before the meeting, without any prior notice or explanation, Smith emailed Kleynerman that he would not attend the meeting. (*Id.* at 215:12-16:10; R.139, DX 112 at 2, 4/25/10 11:07 p.m. email.) This notification came to Kleynerman while he was at the airport

ready to travel to Mexico. (R.154, 9/26/14 Tr. at 79:13-15.) Kleynerman went by himself, and Smith never contacted Glaser to explain why he missed the meeting at KCSR. (R.152, 9/24/14 Tr. at 215:17-22; R.154, 9/26/14 Tr. at 80:2-24.)

Around the same time, Glaser discovered that ACT was delinquent in filing an annual report with the Wisconsin Department of Financial Institutions. (R.152, 9/24/14 Tr. at 225:3-23.) Glaser told Smith to file the report, and Glaser even offered to file the report for ACT, but Smith refused the offer and promised to take care of the situation. (*Id.*) It was important to Glaser that ACT, acting as a sales representative for Red Flag, maintain all legal formalities, because ACT and Red Flag were in a cargo security business where customers checked this sort of information. (*Id.*) Smith failed to do what he promised, and ACT was administratively dissolved. (*Id.* at 224:22-24.) Glaser, as the majority shareholder in Red Flag, was no longer willing to have ACT as Red Flag's sales representative. Accordingly, in May 2010, Glaser sent Kleynerman and Smith a notice terminating

the Sales Representative Agreement between Red Flag and ACT. (R.139, DX 114; R.153, 9/25/14 Tr. at 224:17-24.) The decision to terminate ACT was solely Glaser's; Kleynerman was not involved in it. (R.153, 9/25/14 Tr. at 227:18-20; R.154, 9/26/14 Tr. at 84:23-25.)

F. Following Termination of ACT as Red Flag's Sales Representative, Glaser Asks Kleynerman to Continue to Work With Red Flag on Improving the Cargo Security Seals

By the time Red Flag terminated ACT in May 2010, Glaser had invested over $150,000 into establishing the manufacturing facilities for Red Flag, buying equipment and machinery, and investing in branding efforts. (R.139, DX 50; R.152, 9/24/14 Tr. at 229:22-30:19.) Red Flag, however, still did not have any meaningful sales. Hoping to recover his investment, Glaser asked Kleynerman to continue to work on the product improvements and manufacturing issues, and Kleynerman agreed. (R.152, 9/24/14 Tr. at 226:2-24.)[7]

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[7] In April 2009, Glaser began to loan money to Kleynerman, who had no source of income and was 100% preoccupied with ACT's and later Red (Continued)

Kleynerman was hoping that if additional improvements on the product were made and sales finally came in, at a minimum, ACT would be paid the agreed upon price for the patents. (R.154, 9/26/14 Tr. at 86:10-87:2.) Glaser made no similar offer for Smith to continue to work with Red Flag but left open the possibility for Smith personally to make commissions on any sales of Red Flag's cargo security seals that Smith could generate. (R.139, DX 120.) Kleynerman continued to concentrate on production issues, building new software and scanning capabilities, and Glaser concentrated on sales. (R.154, 9/26/14 Tr. at 89:2-21.)

IV. GLASER SELLS HIS 75% INTEREST IN RED FLAG TO KLEYNERMAN IN FEBRUARY 2011

By February 2011, Glaser had decided that he no longer wanted to be actively involved with Red Flag. (R.152, 9/24/14 Tr. at 227:21-25.) By this time, Glaser had spent almost two years working in this business without any meaningful sales

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Flag's cargo security seals. (R.152, 9/24/14 Tr. at 214:5-11.) Smith knew about these loans. (*Id.*; *see also* R.151, 9/23/14, Tr. at 11:1-9.) Glaser continued to loan money to Kleynerman after ACT was terminated in May 2010.

and no profits, and he had invested over $210,000 of his own money. (*Id.* at 228:1-4.) So Glaser sold his 75% interest in Red Flag to Kleynerman for the same nominal amount that Glaser had paid for the equity interest when he organized Red Flag with Grinberg in 2009. (*Id.* at 233:12-24.) However, Red Flag was still responsible to repay all loans made to it by Glaser and Grinberg. (*Id.* at 228:6-10.) Thus, by February 2011, Kleynerman had a 75% interest in Red Flag, a business that owed close to $300,000 to Glaser and Grinberg; Kleynerman owed Glaser tens of thousands of dollars on personal loans; and Red Flag still had no meaningful sales and had not turned a profit in two of its prior years of operation.

By the time Kleynerman bought Glaser's 75% interest, Red Flag was still purchasing some component parts for the cargo security seals from Ukraine, and this slowed the assembly process and increased the cost. (R.154, 9/26/14 Tr. at 94:9-24.) So, Kleynerman redesigned the locking mechanism to make the assembly more streamlined and less labor-intensive.

(*Id.* at 96:1-18.) These changes—which included changes to the washer and to the cables used in the seal—lowered the cost of production. (*Id.* at 96:25-97:25.) Subsequently, Kleynerman completely redesigned the software supporting the product, to allow a customer to track the seal on the map to determine exactly at which point in shipment the breach of the seal occurs. (*Id.* at 98:3-99:8.) These improvements led to a change in the marketing strategy for Red Flag, to focus not on the carriers but on customers whose cargo the carriers were transporting. (*Id.* at 99:9-23.)

In contrast to ACT, which was operated with minimal overhead, from Kleynerman's and Smith's homes, Red Flag had numerous expenses relating to manufacturing space, utilities, and machinery and equipment, and it had several employees.

Thus, in 2011, Red Flag had combined[8] sales of only $98,152 and a combined net *loss* of *$65,821.* (R.139, DXs 161 and

[8] Since there were two companies, Red Flag Production and Red Flag Marketing, separate tax returns were prepared for each.

162.) In 2012, Red Flag's sales increased exponentially, owing to the improvements made by Kleynerman; they amounted to $1,573,897. (R.139, DXs 163 and 164.) Red Flag's *net income*, however, was only *$20,072* in 2012, in part because Red Flag had to defend itself against Smith's claims brought in late 2011. (*Id.*) Indeed, the Kleynermans' personal adjusted gross income for 2012 was only $56,658. (R.139, DX 165.)

After this lawsuit was filed, the Kleynermans filed for bankruptcy protection in 2012, but their Chapter 13 petition was dismissed because their debts exceeded the limits. *See In re Estate of Kleynerman*, 2:12-bk-21614 (E.D. Wis. Bkrtcy. Feb. 15, 2012).[9] Red Flag had modest sales in 2013 and in 2014,[10] and Red Flag still has not paid back over $300,000 that it owes to Glaser and Grinberg.

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[9] *See e.g.*, *In re Marriage of Lumby*, 116 Wis. 2d 347, 341 N.W.2d 725 (Ct. App. 1983) (taking judicial notice of bankruptcy case record).

[10] During trial, Kleynerman estimated that Red Flag's gross sales from December, 2013 to September, 2014 were somewhere between $600,000 and $800,000. (R.153, 9/25 Tr. at 19:8-21.)

Proceedings in the Circuit Court

On December 16, 2011, Smith sued Kleynerman and Red Flag on his own behalf and purportedly on behalf of ACT, even though Kleynerman was a 50% member in ACT and did not consent to the suit, and Smith's pleading did not describe with particularity his authority for bringing a derivative suit on behalf of ACT, as required by law. *See* Wis. Stat. §§ 183.1101(1) and 183.1101(3). Smith's ten-count complaint included claims of (1) rescission of the transaction between ACT and Red Flag due to Smith's mental incompetence; (2) intentional misrepresentation; (3) negligent misrepresentation; (4) strict responsibility misrepresentation; (5) breach of duty of good faith; (6) breach of fiduciary duty; (7) accounting; (8) unjust enrichment; and (9) violation of Wis. Stat. § 968.61. (R.1.) But the focus, both of the discovery and of the trial, was on Smith's alleged mental incompetence to enter into the transaction.[11]

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[11] The trial court, the Honorable Karen Christensen presiding, denied summary judgment to Kleynerman on all counts, reasoning that Smith's mental incompetence claim was a question of fact (even though Smith (Continued)

Even though none of the claims were dismissed during three years of litigation, at the conclusion of trial Smith abandoned all but three claims: the rescission claim, and Smith's personal claims against Kleynerman for misrepresentation and breach of fiduciary duty. (*See* R.112, A.App.038.)

The jury returned a verdict in favor of Red Flag on the rescission claim and in favor of Kleynerman on the misrepresentation claim.[12] (R.112, A.App.038-043.) On the breach of fiduciary duty claim, the jury found in favor of Smith and awarded him $499,000 in compensatory damages. (*Id.*)

The parties filed motions after verdict; Kleynerman sought judgment notwithstanding the verdict or a new trial on the breach of fiduciary duty claim and punitive damages, and Smith sought a change in the verdict on the misrepresentation

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had no expert testimony that he was incompetent at the time he signed the agreements), and all other claims depended on the resolution of this issue. (R.93.)

[12] The jury awarded $200,000 to Smith in punitive damages on the misrepresentation claim (even though it found no liability), and the circuit court struck the award.

claim. (R.116 to 121.) The circuit court granted Kleynerman's motion on punitive damages, striking the award, but entered judgment on the verdict in all other respects. (R.122, A.App.001.)

The circuit court did not address any of Kleynerman's arguments why the breach of fiduciary duty claim was legally deficient, simply deferring to the jury's decision. It explained its reasoning as follows:

> You know, the jury trial is something you both requested. The jury comes in here. They deliberate on the evidence. We're supposed to defer to them as to their findings. You know, it's basically the constitutional way in which we like to do things in this country. So you presented your cases before them. They found what they found and unless I see that you're citing to any particular lack of evidence which a jury cannot draw the inference to find their answer to, they will be sustained.

(R.156, 11/25/14 Tr. at 19:3-13, A.App.022.)

STANDARD OF REVIEW

This appeal is before the Court on review of an order denying motions for judgment notwithstanding the verdict. The Court reviews such motions de novo "applying the same

standards as the trial court." *Logterman v. Dawson*, 190 Wis. 2d 90, 101, 526 N.W.2d 768 (Ct. App. 1994). "A motion for JNOV does not challenge the sufficiency of the evidence to support the verdict, but rather whether the facts found are sufficient to permit recovery as a matter of law." *Id.*

The questions before the Court on this review are all questions of law. Did Kleynerman, as an LLC member, owe a fiduciary duty to Smith, as the other member, on the facts presented at trial, and, if so, is there competent evidence from which the jury could have found that duty breached? *Century Capital Grp. v. Barthels*, 196 Wis. 2d 806, 812-13, 539 N.W.2d 691 (Ct. App. 1995); *Zastrow v. Journal Comm'ns, Inc.*, 2006 WI 72, ¶12, 291 Wis. 2d 426, 718 N.W.2d 51.

Was the claim barred by the statute of limitations? *Zastrow*, 291 Wis. 2d 426, ¶12; *Smith v. Milwaukee Cnty.*, 149 Wis. 2d 934, 937, 440 N.W.2d 360 (1989).

Did Smith have standing to recover damages allegedly sustained by ACT? *Cf. Borne v. Gonstead Advanced*

Techniques, Inc., 2003 WI App 135, ¶10, 266 Wis. 2d 253, 667 N.W.2d 709.

The Court decides these legal issues without deference to the circuit court.

Kleynerman also challenges the amount of the damages award. The test is whether there is any *credible evidence* to support the award. *Bastman v. Stettin Mut. Ins. Co.*, 92 Wis. 2d 542, 547, 285 N.W.2d 626, 628 (1979) (affirming the trial court's change of jury verdict answer); Wis. Stat. § 805.14(1); *Richards v. Mendivil*, 200 Wis. 2d 665, 670, 548 N.W.2d 85, 88 (Ct. App. 1996).

Finally, "[a]ppellate courts review a circuit court's decision to admit or exclude expert testimony under an erroneous exercise of discretion standard." *State v. Giese*, 2014 WI App 92, ¶16, 356 Wis. 2d 796, 854 N.W.2d 687.

ARGUMENT

The judgment should be reversed on five separate grounds, each of them sufficient for reversal. As a matter of law, no fiduciary duty arose on the facts presented. As a matter of

law, Kleynerman did not breach any fiduciary duty. Smith's breach of fiduciary duty claim is barred by the (then) two-year statute of limitations. Smith has no standing to recover damages allegedly suffered by ACT. No competent evidence was presented supporting a damages award.

I. KLEYNERMAN DID NOT OWE SMITH A FIDUCIARY DUTY TO ACT IN FURTHERANCE OF SMITH'S INTERESTS

At the end of trial, ACT dismissed its breach of fiduciary duty claims against Kleynerman. Therefore, the *jury was not asked to decide whether Kleynerman breached a fiduciary duty to ACT*. (R.112, A.App.041.) The only breach of fiduciary duty claim that was presented to the jury was Smith's claim that Kleynerman had a fiduciary duty to act in furtherance of Smith's interest as it related to the transaction, and breached that duty. (R.155, 9/29/14 Tr. at 21:18-20.) As a matter of law, Kleynerman did not owe Smith such a duty. If the facts presented at trial do not give rise to a fiduciary duty as a matter of law (which is true here), the Court must reverse a judgment based on a contrary verdict. *See Century Capital Grp. v.*

Barthels, 196 Wis. 2d 806, 812-13, 539 N.W.2d 691 (Ct. App. 1995) (bench trial); *Logterman*, 190 Wis. 2d at 101 (reversing denial of JNOV).

Wisconsin recognizes two types of fiduciary relationships: "(1) those specifically created by contract or a formal legal relationship such as principal and agent, attorney and client, trust and trustee, guardian and ward, and (2) those implied in law due to the factual situation surrounding the transactions and relationships of the parties to each other and to the questioned transactions." *Prod. Credit Ass'n of Lancaster v. Croft*, 143 Wis. 2d. 746, 753, 423 N.W.2d 544, 546 (Ct. App. 1988). These limited categories reflect the underpinning of fiduciary law, which was "developed to address claimed abuses by one who *had accepted a position of authority with regard to the affairs of another.*" *Zastrow*, 291 Wis. 2d 426, ¶25 (emphasis added).

In *Zastrow*, the Court acknowledged the "elusive" nature of fiduciary duties, *id.*, ¶26, but reaffirmed that fiduciary

duties arise only in "paradigm" relationships (*i.e.*, trustee, guardian, agent, or attorney) or relationships "sufficiently like" the paradigm relationships, *id.*, ¶25. The thread that binds all of these fiduciary relationships is the voluntariness of the duty: did the party by contract or by the "*conscious undertaking* of a special position with regard to another," undertake to be a fiduciary? *Id.*, ¶28 (emphasis added).

Here, none of the facts presented at trial, individually or collectively, is *legally* sufficient to evidence Kleynerman's voluntary assumption of a duty to act in furtherance of Smith's interests in the transaction.

There was no contract between Kleynerman and Smith by which Kleynerman agreed to act as a fiduciary in furtherance of Smith's interests in the transaction (or otherwise). The only document that Smith has identified as the basis of the alleged duty[13] is the MOU that Smith, Kleynerman, and Glaser

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[13] *See* Smith's Opposition to Kleynerman's Motion Notwithstanding the Verdict. (R.121, at 2 ("the fiduciary duty of Kleynerman to Smith was (Continued)

signed in March 2009 to outline the terms of the transaction. (R.139, DX 56, A.App.140.) But *Kleynerman undertook no fiduciary duty to Smith* pursuant to that document.

The only provision where Kleynerman agrees to act on behalf of anyone else is on page, two where Kleynerman agreed to act on *behalf of ACT* to simply perform the ministerial task of signing patent assignment forms. (*Id.* at p.2.) There is nothing in this provision that gives rise to Kleynerman's assumption of a fiduciary duty to Smith personally. The undisputed evidence at trial shows that this authority for Kleynerman to sign the patent assignment forms on behalf of ACT in order to file them with the Patent Office after the Asset Sale Agreement was signed was a geographical issue—Kleynerman and Glaser were both in Milwaukee. (R.154, 9/26/14 Tr. at 130:18-20.) Furthermore, Smith acknowledged that only Kleynerman's name appeared on the form and said that he was

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created by the Memorandum of Understanding which allowed Kleynerman to act on behalf of Smith by power of attorney.").)

willing to sign this form too *if necessary*, but the parties determined that it was not. (R.139, DX 59, A.App.144.) The patent assignment forms are a "ministerial" part of the patent transfer process that gives public notice of a patent transfer, much like the recording of a mortgage or a security interest. [14] The recording of the transfer is unrelated to whether patents are actually or validly sold. *Id.* Finally, Smith was notified on June 10, 2009 that Kleynerman had signed the patent assignment forms on May 26, after Smith had communicated his initial agreement to the agreements and before Smith asked to keep ACT's web site address for himself. (R.139, PX 12-13, 16, A.App.127-30.) The MOU simply does not provide any basis to conclude that Kleynerman voluntarily assumed an obligation to put Smith's interests ahead of Kleynerman's (as is necessary for a fiduciary) and negotiate a better deal for Smith personally, *i.e.*, to act in furtherance of Smith's interest in the transaction.

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[14] USPTO, "FAQs," http://www.uspto.gov/learning-and-resources/transferring-ownership-assignments-faqs ("What does it mean when a document is " recorded ?").

There was no evidence presented at trial that demonstrated any inequality in knowledge of the facts involved in the transaction or disparity in Smith's and Kleynerman's position relative to the transaction that would support the existence of a fiduciary duty for Kleynerman to act in furtherance of *Smith's* interests.

First and foremost, Smith had complete knowledge of the terms of the transaction. Smith received drafts of the Asset Sale Agreement and the Sales Representative Agreement from Glaser on April 24, 2009. (R.139, DX 57, A.App.142.) Smith provided numerous comments and changes to the agreements on May 11, 2009. (R.139, DX 60.) Glaser sent revised drafts that incorporated Smith's changes and comments on May 22, 2009, and Smith was ready to sign the documents and told Glaser so. (R.139, DX 62, A.App.151.) Yet, the next day, Smith requested a new significant change to the deal, namely that ACT retain its website address. (*Id.*) Smith's request demonstrated that Smith knew that Red Flag could terminate ACT after one year and that

Red Flag may decide not to continue doing business with Smith personally. (R.139, DX 63, A.App.155.) Smith wanted to retain the web address for his own consulting business so that he could use the materials from the website in case Red Flag decided not to deal with Smith in the future. Glaser eventually agreed with Smith's last-minute demand (R.139, DX 65), and Smith signed the agreements to effectuate the transaction. (R.139, DX 66-69.)

Importantly, Kleynerman was entirely absent from these negotiations: all of the comments and changes to the drafts were provided by Smith. If anything, Kleynerman had less knowledge of the details of the deal than Smith had. Kleynerman testified that to him it was important that Red Flag would provide money to build a manufacturing facility in Milwaukee to make the seals, that Red Flag compensate ACT for the patents so that ACT could pay its patent lawyers, and that ACT be given an opportunity to earn a significant commission (50% of Red Flag's gross profit) from the sale of the seals. (R.154, 9/26/14 Tr. at 57:16-58:19.) Once Red Flag agreed to these basic provisions of

the deal, as reflected in the MOU, Kleynerman was not concerned with the rest. (*Id.*)

Nor was there any other inequality of age or weakness of business intelligence between Kleynerman and Smith. Smith testified that he was an experienced businessman with an MBA and, as evident from his numerous comments on the drafts of the agreements, he had read and understood them and engaged in negotiations of their terms. (R.139, DX 25, 31, 34, and 63.) While Smith argued at trial that he was mentally incompetent at the time of the transaction, this claim was rebutted by abundant evidence of his participating in numerous activities around the relevant time (from being a plaintiff in another lawsuit against his homebuilding company to refinancing his mortgage to participating in business activities on behalf of ACT and his other companies). The incompetence claim was ultimately rejected by the jury. (R.112, A.App.038.)

Nor is there any evidence that Kleynerman had any active role in Smith's legal and financial affairs in the past, to

permit the drawing of an inference that Kleynerman had agreed to act as Smith's fiduciary and to make sure that Smith's personal interests were protected. While Smith argued that Kleynerman had told Smith in 2007, after Smith's wife's death, that Kleynerman would take care of the business (R.150, 9/22/14 Tr. at 164:6), a claim that is belied by Smith's own active role in ACT, even Smith could not come up with a claim that Kleynerman promised Smith to take care of him personally, and, in essence, become Smith's guardian. (*See id.*) Whatever trust and confidence Smith put into Kleynerman, such matters do not give rise to a fiduciary relationship. *Jackson v. McKay-Davis Funeral Home, Inc.*, 830 F. Supp. 2d 635, 648 (E.D. Wis. 2011) (holding that a funeral home did not become a fiduciary even though the family of the deceased put trust and confidence in the funeral home's care for the remains of the deceased). Similarly, whatever advice and encouragement Kleynerman provided to Smith, or Smith expected of Kleynerman as a friend, does not create a fiduciary relationship. *Croft*, 143 Wis. 2d at 756, 423

N.W.2d at 547 (holding that a lender did not become a fiduciary of a farmer notwithstanding farmer's claims that he sought advice from the lender and relied on the lender's trust, honesty, integrity, representations, superior knowledge and sophistication).

There is no ground for finding a fiduciary duty here. Not only was there no evidence of a conscious undertaking by Kleynerman to act for Smith, there was no evidence of the other fiduciary relationship factors, such as "inequality, dependence, weakness of age, of mental strength, business intelligence, knowledge of facts involved, or other conditions giving to one an advantage over the other." *Croft*, 143 Wis. 2d at 755, 423 N.W.2d at 547.

Recognizing Kleynerman as a fiduciary of Smith in this case would make Kleynerman an involuntary guarantor of Smith's business decision concerning the transaction, a result that our courts have consistently rejected. See *Croft*, 143 Wis. 2d at 757, 423 N.W.2d at 548 (citing *Gries v. First Nat. Bank of*

Milwaukee, 82 Wis. 2d 774, 780, 264 N.W.2d 254, 257 (1978); *Merrill Lynch, Pierce, etc. v. Boeck*, 127 Wis. 2d 127, 377 N.W.2d 605 (1985) (holding that broker should not be a guarantor of customer's investments)). This is especially true here because Smith was fully aware of the terms of the transaction and of the possibility that Red Flag might decide not to do business with him after a year. (R.139, DX 63, A.App.155.) That Red Flag indeed chose to terminate ACT as a sales representative after one year for Smith's failure to maintain ACT in good standing and for Smith's failure to appear at a very important sales meeting in Mexico (R.139, DX 112, 117), and decided to continue the relationship with Kleynerman, and offered Smith an opportunity to make commissions, does not mean that Kleynerman had a fiduciary duty to negotiate different agreements to provide for a different outcome. *Thiel v. Wride*, No. 12-CV-530, 2013 WL 5936973 (E.D. Wis. Nov. 4, 2013) (dismissing breach of fiduciary claim by one member in a limited liability company against

another because the plaintiff was a sophisticated investor who should have anticipated the risk.)

It would be an unprecedented departure from *Zastrow* and Wisconsin fiduciary duty law to impose an involuntary fiduciary obligation on Kleynerman to protect Smith's interest in a transaction that Smith negotiated and signed both on his own behalf and on behalf of the LLC in which he was a member. Such a decision would create no logical stopping point for fiduciary duty claims.

II. THE UNDISPUTED FACTS AT TRIAL SHOW THAT, AS A MATTER OF LAW, KLEYNERMAN DID NOT *BREACH* A FIDUCIARY DUTY TO SMITH

Breach of a fiduciary duty does not occur simply because a fiduciary does something adverse to the principal's interest; rather a breach of a fiduciary duty requires "disloyalty or infidelity." *Zastrow*, 291 Wis. 2d 426, ¶30. The evidence at trial precludes a conclusion that Kleynerman was disloyal to Smith.

In early 2009, ACT was on the precipice of financial collapse. (R.139, DX 12, 13, 14.) Since starting the operations in

2002, ACT had only made money in 2006 and 2007, and then only because of orders from one customer, Cemex. (R.139, DX 2-9). When Cemex stopped ordering in 2007, ACT had no other viable customers that would order enough seals to provide any meaningful income to Smith and Kleynerman.

Furthermore, ACT did not have its own funds to pre-pay the manufacturer in Ukraine for a significant stock of seals to be used in subsequent re-sales. (R.139, DX 17.) Kleynerman did not have the financial means, and he and Smith were facing other lawsuits for debts of Smith's and Kleynerman's other business venture. (R.139, DX 17.) ACT was also facing a collection action from its patent attorneys. (R.139, DX 12.) Smith was not willing to invest his own funds to build a manufacturing platform for ACT. Smith fully understood the precarious financial position of ACT and acknowledged that he and Kleynerman would need to close ACT down. (R.139, DX 14, at A.App.136.) Kleynerman could have told Smith to close ACT at that time, distributed the assets (the patents) to both of them

and owned them jointly, and continued their separate lives and business activities.[15]

But instead of *breaching* whatever obligations Smith claims Kleynerman had, Kleynerman decided to find a way to keep ACT afloat, to provide an opportunity for ACT's long-term success, and thereby provide an opportunity for Smith. Kleynerman did not act out of self-interest, but in the interest of ACT, a company in which he and Smith were equal members. If it weren't for Kleynerman, Glaser and Grinberg would not have agreed to expend hundreds of thousands of dollars of their own money to build a manufacturing capability to make seals in Milwaukee.

That Kleynerman was not disloyal to Smith in connection with the transaction is best evidenced by Kleynerman's decision to stand by Smith when Smith sought to

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[15] As a co-owner of a patent, Kleynerman could have licensed it to any third party, and neither Kleynerman nor Kleynerman's licensee could be sued for patent infringement. *See Israel Bio-Eng'g Project v. Amgen, Inc.*, 475 F.3d 1256, 1264 (Fed. Cir. 2007).

change the terms of the deal at the last minute and keep ACT's website for Smith's consulting business. (R.139, DX 65.) As much as Glaser was upset with the last minute-change, he agreed to it, seeing the demonstrated unity in ACT's position from both of its members. (*Id.*)

This shows that Kleynerman acted in the best interests of ACT, was loyal to Smith, and did not act in own self-interest to harm Smith. Only a year later did Kleynerman receive something that Smith did not share in—the opportunity to continue to work with Red Flag. But Kleynerman did not do anything to cause this result—the evidence was clear and uncontroverted that Glaser, as the President of Red Flag, decided to terminate ACT and asked Kleynerman to finish what was started (making a good product and building a manufacturing capability in the United States). Further, Smith envisioned this outcome even before Smith signed the documents for the transaction. (R.139, DX 63.) There is no basis in law or fact for Smith to now demand that Kleynerman should have negotiated a

provision in the agreements that would have guaranteed Smith's continued involvement with Red Flag. There is no competent evidence to support the jury's finding that Kleynerman breached a fiduciary duty to Smith, and Kleynerman is entitled to judgment.

III. SMITH'S BREACH OF FIDUCIARY DUTY CLAIM IS BARRED BY THE STATUTE OF LIMITATIONS

Kleynerman is entitled to judgment notwithstanding the verdict for another reason: Smith's breach of fiduciary duty claim is barred by the statute of limitations. In *Zastrow*, 291 Wis. 2d 426, ¶38, the Supreme Court held that Wis. Stat. § 893.57 prescribes the limitations period for a breach of fiduciary duty claim. When Smith's claim accrued on June 5, 2009 at the closing of the transaction, that statute of limitations was two years. Wis. Stat. § 893.57 (2007-08). Even though the legislature lengthened the limitations period from two to three years in the wake of *Zastrow*, that change was prospective, applying only to claims accruing on or after February 26, 2010. *See* 2009 Wis. Act 120, §2. Because Smith's claim accrued on June 5, 2009, when

the agreements were signed, the limitations period was two years, and it expired on June 5, 2011. Because Smith did not file suit until December 2011, his claim is time-barred.

Under *Kolpin v. Pioneer Power & Light Co.*, 162 Wis. 2d 1, 469 N.W.2d 595 (1991), a plaintiff's claim accrues when the plaintiff knows, or in the exercise of reasonable care should discover, both that he has suffered an injury and the source of that injury. *Id.* at 24-27, 469 N.W.2d at 604-05. Reasonable care means "such diligence as the great majority of persons would use in the same or similar circumstances" to discover the cause of the asserted injury. *Spitler v. Dean*, 148 Wis. 2d 630, 638, 436 N.W.2d 308, 311 (1989). "Plaintiffs may not close their eyes to means of information reasonably accessible to them and must in good faith apply their attention to those particulars which may be inferred to be within their reach." *Id.*

Given that Smith knew in June 2009 that nothing in the agreements for the transaction guaranteed Smith's continued work with Red Flag beyond a year after the deal closed (R.139,

DX 63), which is precisely the basis for his claim, Smith knew of his alleged injury (a deal that did not sufficiently protect him) and the source of that alleged injury (Kleynerman's alleged failure to negotiate a better deal) in June 2009. Thus, Smith had to bring his breach of fiduciary duty claim on account of the transaction not later than June 5, 2011, two years after he signed the deal documents. He waited to file this action until December 2011. His claim is time-barred and must be dismissed.

IV. SMITH HAS NO STANDING TO RECOVER DAMAGES THAT ACT ALLEGEDLY SUSTAINED

The breach of fiduciary duty claim that went to the jury was a claim by Smith individually against Kleynerman individually. (R.155, 9/29/14 Tr. at 21:18-20; R.112, A.App.041.) But the only evidence of damages presented at trial was for ACT's lost profits. (*E.g.*, R.153, 9/25/14 Tr. at 117:15-18, A.App.191 ("did you come to an opinion regarding the lost profits to ACT in the period of time 2009 to the present? A. Yes, I did.").) Smith has no standing to recover ACT's lost profits in a

direct action against Kleynerman. The circuit court's decision to allow Smith to recover must, therefore, be reversed.

Smith originally asserted claims on his own behalf, and derivatively, on behalf of ACT. (R.1.) Smith's complaint setting out ACT's derivative claims failed to comply with the Wis. Stat. § 183.1101(3) pleading requirement ("the complaint shall describe with particularity the authorization of the member to bring the action"), but this defect became moot during trial, when Smith dismissed all of ACT's claims except the rescission claim. Therefore, the only breach of fiduciary duty claim (and the only claim that Smith prevailed on) was a direct claim by him against Kleynerman. (R.122, A.App.002.) The only evidence of damages, however, that Smith presented through his expert, Paul Rodrigues,[16] was for alleged damages to ACT, not to Smith personally. Rodrigues' opinions presented no legally recognized damages *to Smith* for a breach of fiduciary duty. Instead,

[16] As discussed in Section V.B., below, this evidence was incompetent.

Rodrigues' opinions explained the harm to *ACT* that purportedly occurred as a result of the transaction.

Rodrigues testified simply that ACT had "lost profits" based on the theory that, but for the transaction, ACT would not have sold its patents to Red Flag and would have made the same sales that Red Flag made from June 2009 until trial. (R.153, 9/25/14 Tr. at 145:16-18, A.App.220.)[17] Rodrigues only calculated ACT's lost profits (and Smith's corresponding share as a 50% member). (*Id.* at 138:10-13, A.App.212.) Repeatedly, Rodrigues confirmed that he was calculating only the "loss of profits that ACT would have had since the time of the transaction through" trial. (*Id.* at 163:20-22, A.App.238.)

Not only was Rodrigues' methodology utterly flawed, as discussed below, these damages at best would be damages to ACT rather than to ACT's members. "[I]n a direct action the

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[17] Rodrigues *applied ACT's profit margin* in 2006-07 (two out of six years of its existence) to *Red Flag's sales*, and determined that ACT would therefore have realized nearly a million dollars in profit from the time of the transaction in 2009 until the trial. (R.153, 9/25/14 Tr. at 143:19-145:18, 163:23-164:4, A.App.218-20, 238-39.)

individual may not claim damages sustained by the corporation or damages that the corporation could have sought in its own capacity." *Park Bank v. Westburg*, 2013 WI 57, ¶44, 348 Wis. 2d 409, 832 N.W.2d 539.

Claims for lost profits, described by Rodrigues, are quintessential corporate (rather than shareholder) claims. *E.g.*, *Nelson v. Anderson*, 84 Cal. Rptr. 2d 753, 762 (Ct. App. 1999) ("The economic damages proven at trial were lost profits to the corporation as the result of rejected opportunities . . . . A lost opportunity to increase corporate assets or net worth is the most common situation in which a derivative action is the only appropriate remedy."). When "the primary injury set forth is to the corporation," only a derivative action—that is, one on behalf of the corporation—may be maintained. *Rose v. Schantz*, 56 Wis. 2d 222, 229, 201 N.W.2d 593 (1972). An individual action by the shareholder cannot be brought. *Id.*

Indeed, in *Read v. Read*, 205 Wis. 2d 558, 570, 556 N.W.2d 768 (Ct. App. 1996), directors/shareholders "mismanaged

the corporation and engaged in self-dealing in violation of their fiduciary duty" to the other shareholder through transactions with other corporate entities in which the plaintiff shareholder had no equity interest. *Id.* Regardless of what harm the individual shareholder suffered, the claim belonged to the corporation, and no damages could be recovered in a direct action by the shareholder. *Id.*; *see also Notz v. Everett Smith Group, Ltd.*, 2009 WI 30, ¶¶22-23, 316 Wis. 2d 640, 764 N.W.2d 904; *Nelson*, 84 Cal. Rptr. 2d at 764 (reversing jury verdict because one (of two) shareholders brought *direct*, rather than *derivative*, action against other shareholder seeking lost profits).

Smith's expert described only the harm that ACT purportedly suffered. Smith cannot recover damages for that harm. The Court should reverse the circuit court's denial of judgment notwithstanding the verdict.

V. THERE WAS NO COMPETENT EVIDENCE PRESENTED THAT SMITH SUFFERED DAMAGES WORTH $499,000 FOR KLEYNERMAN'S ALLEGED BREACH OF FIDUCIARY DUTY

A. Smith Did Not Present Any Proof of Damages for His Breach of Fiduciary Duty Claim

Smith's damages expert offered only two opinions: (1) that Smith lost his interest in ACT and (2) that Smith suffered damages (as a member in ACT) as a result of the fraudulent inducement regarding the transaction. (R.139, PX 26; R.153, 9/25/14 Tr. at 183:19-24, A.App.258.)[18] Rodrigues' first opinion is wrong because, as Rodrigues admitted, Smith still owns his 50% interest in ACT. (R.153, 9/25/14 Tr. at 162:21-24, A.App.237.) Rodrigues' second opinion addressed only the misrepresentation claims (on which the jury found in favor of Kleynerman). Therefore, *Rodrigues' opinions did not address breach of fiduciary duty damages at all.*

[18] In his expert report, Rodrigues calculated Smith's damages at $175,000. (R.139, PX 26.) During trial, Rodrigues increased the figure from $175,000 to 50% of ACT's alleged lost profit between $898,000 and $978,000, which Rodrigues calculated based on ACT's profit margin (2006-2007) and Red Flag's "sales" (2009-2014). (R.153, 9/25/14 Tr. at 146:8-13, A.App.221.)

When Kleynerman sought to clarify whether Rodrigues was testifying as to damages other than for misrepresentation, Smith's counsel *twice* suggested that he was stipulating that Rodrigues was not testifying beyond the misrepresentation claim. (R.153, Tr. 9/25/14 at 182:15-17 & 185:6, A.App.257, 260.) When Kleynerman sought to clarify the legal theories on which Rodrigues was opining, Smith repeatedly objected, and the circuit court sustained those objections. (*Id.* at 184:14-85:5, A.App.259-60.) As a result of Smith's objections, his counsel's offer to stipulate, and his expert's limited opinions, Smith presented no evidence whatsoever of damages for breach of fiduciary duty.

Because Smith presented no evidence of damages for breach of fiduciary duty, Kleynerman is entitled to judgment notwithstanding the verdict. *See Sporleder v. Gonis*, 68 Wis. 2d 554, 560, 229 N.W.2d 602 (1975) ("The damages . . . must be certain, both in their nature and in respect to the cause from which they proceed." (citation omitted)); *Berner Cheese v. Krug*,

2008 WI 95, ¶59, 312 Wis. 2d 251, 270, 752 N.W.2d 800 (affirming circuit court dismissal of breach of fiduciary duty claim when damages expert did not provide proper damages evidence); *see also Hanz Trucking, Inc. v. Harris Bros. Co.*, 29 Wis. 2d 254, 269, 138 N.W.2d 238, 246 (1965) (reversing for new trial on damages and explaining "The burden of proof was upon the plaintiff to establish his loss.").

B. Smith's Expert's Opinion Was Based on Flawed Methodology

Even if the Court were to consider Rodrigues' testimony as supporting damages for Smith's direct breach of fiduciary duty claim (which, as discussed above, it should not do), Rodrigues' opinion testimony was improper. Rodrigues did not use a reliable methodology for calculating damages, and Kleynerman objected to his testimony on that basis. (R.153, 9/25/14 Tr. at 193:17-97:19, A.App.268-72.) Pursuant to Wis. Stat. § 907.02, the testimony should have been disallowed. Instead of applying the current version of Wis. Stat. § 907.02, which requires the court to serve as gatekeeper to exclude expert

testimony if it is not "the product of reliable principles and methods," the circuit court applied the old "relevance" test[19] that was legislatively supplanted ten-and-a-half months before this case was filed. *See* 2011 Wis. Act 2. Under the new standard, known as the *Daubert* standard, the court had the duty to exclude an expert opinion employing unreliable methodology, and the court's failure to do so is reversible error. *Cf. Wasson v. Peabody Coal Co.*, 542 F.3d 1172, 1176 (7th Cir. 2008).

Here, Rodrigues' methodology was clearly unreliable. *See id.* He calculated *ACT's* purported *damages* by taking *ACT*'s *profit margin* of 40% from the best two years of its six years of

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[19] The circuit court reasoned: "If you want to object as to what he testified about, I gave you the opportunity to cross examine and you have another expert that's going to testify. That's a fair . . . engagement of counter views. . . . But there's nothing for the court to do. . . . You did it through cross examination. . . . [The jury has] to sort it out. I can't sort it out for you." (R.153, 9/25/14 Tr. at 196:3-13, A.App.271.) That is an articulation of the old test. *See, e.g.*, *260 N. 12th St., LLC v. State DOT*, 2011 WI 103, ¶55, 338 Wis. 2d 34, 808 N.W.2d 372 ("In a state such as Wisconsin, where substantially unlimited cross-examination is permitted, the underlying theory or principle on which admissibility is based can be attacked by cross-examination or by other types of impeachment. Whether a scientific witness whose testimony is relevant is believed is a question of credibility for the finder of fact, but it clearly is admissible." (citations omitted)); *see also id.*, ¶55 n.10.

operations and imposing that profit margin on *Red Flag's "sales"*[20] from 2009 through the present. (R.153, 9/25/14 Tr. at 143:17-25, A.App.218.) Rodrigues' implicit premise was that if the transaction between ACT and Red Flag had not occurred, ACT would have achieved the same sales that Red Flag achieved from 2009 to present and would have maintained for five years straight a profit margin that ACT could not maintain in four of its six previous years. (*Id.* at 145:16-18 (describing "total lost profits to ACT assuming ACT would have had those sales instead of Red Flag").) However, when asked whether ACT would have actually made the same sales as Red Flag made, Rodrigues insisted that he was not offering an opinion that ACT *in fact would have* made those sales. (*Id.* at 164:5-8.)

Rodrigues did not undertake any investigation to determine *how ACT could possibly achieve the sales that Red*

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[20] Indeed, even Rodrigues calculation of Red Flag's "sales" was grossly false. To determine sales, Rodrigues took the figures from Red Flag's invoices that included shipping costs, travel expenses, and GPS scanner costs, on which Red Flag makes *no profit* and simply passes the cost to the customers. (R.153, 9/25/14 Tr. at 188:1-25, A.App.263.)

Flag did between 2009 and 2014. He did not consider that ACT was on the verge of closing its operations in 2009 (R.139, DX 14) and that ACT had no money to build a manufacturing capability in the United States and no source of funding. Rodrigues also did not consider that ACT had no money to prepay for seals made by others, or that buying third-party-made seals was no longer viable because of duties imposed on the products' export. (R.153, 9/25/14, Tr. at 166:11-17, A.App.241.) Nor did Rodrigues understand that Red Flag finally began to sell in 2011-2012, only after the manufacturing capability was built and Kleynerman redesigned the seals. *See, e.g.*, *id.* at 169:6-16; Part III.F., above. Rodrigues also disregarded the fact that Red Flag's *actual profits* from 2009 through 2013 were a total of $108,765. (R.139, DX 154, 157, 159, 161, and 163.) In short, Rodrigues conceded that he "didn't know what Red Flag was actually doing in production." (R.153, 9/25/14 Tr. at 170:8-9, A.App.240.)

Rather than testifying that ACT would have made the sales that Red Flag made from 2009 to 2014, Rodrigues

simply testified that "*if*" ACT had done so and had maintained its two best years' profit margin, the resulting profits would have been in the range he identified. (*Id.* at 164:5-17.) This opinion further emphasizes that Smith presented no evidence of damages for breach of fiduciary duty, but rather sought to unwind the transaction and recover his share in ACT's alleged forgone profits.

Not only was Rodrigues' methodology unreliable for determining ACT's lost profits, it defied common sense. A reseller on the verge of dissolution (as ACT was) would not be expected to grow its sales (and maintain a consistent profit margin achieved only in two out of six years of its existence) to the same extent as a company that invested hundreds of thousands of dollars in building manufacturing capabilities. Furthermore, a company that manufactures, employs people, and pays for utilities, marketing, shipping, etc. (as ACT would have to do *if it were to achieve the same sales as Red Flag did between 2009 and 2014*) cannot have the same profit margin as a company

that simply buys and re-sells out of the homes of its two members (as ACT was doing between 2002 and 2008, which allowed ACT to have a 40% margin in just two of the six years because of one large customer that went away). A damages award based on Rodrigues' testimony made Smith *far better off* financially than Kleynerman, notwithstanding the latter's working around the clock in a business in the last five years that still owes hundreds of thousands of dollars to Glaser and Grinberg.

Because Rodrigues expressly disclaimed an opinion regarding what sales ACT actually would have made but for the transaction, his opinion leaves causation to speculation that is undercut by the undisputed testimony at trial. Damages cannot be based on such speculation or conjecture. *Murray v. Holiday Rambler, Inc.*, 83 Wis. 2d 406, 434, 265 N.W.2d 513, 526 (1978) (reversing damages award not based on competent evidence).

The circuit court should have granted Kleynerman judgment notwithstanding the verdict because Smith presented

no competent evidence of any damages that he sustained on account of Kleynerman's alleged breach of fiduciary duty.

CONCLUSION

This Court should reverse the judgment entered below and remand with directions to enter judgment in favor of Kleynerman on Smith's breach of fiduciary duty claim.

Dated: June 5, 2015

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FORM AND LENGTH AND ELECTRONIC BRIEF CERTIFICATION

I hereby certify that this brief conforms to the rules contained in § 809.19(8)(b) and (c) for a brief produced with a proportional serif font. The length of this brief is 10,685 words.

I have submitted an electronic copy of the brief, which complies with the requirements of § 809.19(12). I certify that the electronic brief is identical in content and format to the paper form of the brief filed as of this date, other than the signature.

Dated: June 5, 2015

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CERTIFICATE OF MAILING

I hereby certify that on this date I caused the original and 10 copies of Brief of Defendant-Appellant-Cross-Respondent Greg Kleynerman to be sent by Federal Express for overnight delivery to the clerk, and therefore the brief is filed on this date pursuant to § 809.80(3)(b)(2).

Dated: June 5, 2015

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