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1 UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK
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3 DGI-BNSF CORP.,

4 Plaintiff,

5 v. 18CV3252(VEC)

6 TRT LEASECO, LLC,

7 Defendant.

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New York, N.Y.
9 December 11, 2020
1:30 p.m.
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Before:
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HON. VALERIE E. CAPRONI,
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District Judge
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APPEARANCES
14
POLLACK SOLOMON DUFFY, LLP
15 Attorneys for Plaintiff
BY: BARRY S. POLLACK
16 PHILLIP RAKHUNOV

17 RUBERRY STALMACK & GARVEY, LLC
Attorneys for Defendant
18 BY: EDWARD RUBERRY
ALEXANDER R. HESS
19 JAMES M. BARTON

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1 THE COURT: Good afternoon, everybody. I see
2 Mr. Pollack, Mr. Rakhunov. I see Mr. Barton, Mr. Hess.
3 Mr. Ruberry is lost. There's Mr. Ruberry.
4 MR. RUBERRY: Good afternoon, your Honor.
5 THE COURT: Okay, folks. So, first off, I don't
6 forget, if you could email us a version -- I need an electronic
7 version of all of the exhibits that are in evidence. We have
8 hard copies of the ones that don't have 100 numbers, but if you
9 could give us electronic versions of those, as well, we would
10 appreciate it.
11 MR. HESS: Yes, your Honor.
12 MR. RAKHUNOV: Yes, your Honor.
13 THE COURT: I'm also going to require you, at the end
14 of all of this, to provide updated revised versions of your
15 findings of fact and conclusions of law with citations to the
16 record and that conform to what actually came into evidence.
17 How long does the plaintiff need?
18 MR. POLLACK: We only have rough drafts right now of
19 the transcript, so I was going to say two weeks, but that takes
20 us right into the holidays. So the end of the first week of
21 January. And I would hope we can speak with defense counsel
22 if, for some reason, any of the final transcripts take longer
23 than anticipated, having a short period after that.
24 THE COURT: Sure.
25 How long does the defendant want?

1 MR. HESS: Your Honor, my understanding, from our
2 communications with the court reporter, is that we can expect
3 the final drafts of the transcripts 30 days after trial. That
4 would take us into early January. So perhaps we could make it
5 the end of January, your Honor.
6 THE COURT: Yes. Actually, let's do this: So your
7 revised findings of fact — both parties — revised findings of
8 fact and conclusions of law are due February the 5th.
9 MR. RUBERRY: Thank you, Judge.
10 THE COURT: That should give you enough time.
11 MR. POLLACK: Yes, your Honor. So simultaneous, one
12 filing each.
13 THE COURT: Right.
14 Okay. So, you predicted for me, when I last saw you,
15 which seems like a long time ago, but it really isn't, that you
16 need an hour and a half for summations. Is that still a good
17 estimate, Mr. Pollack?
18 MR. POLLACK: Yes. It is harder to predict exactly as
19 how much I use in the opening summation, but if it's anything
20 like a practice round, it depends if you have questions, your
21 Honor, along the way, but I would anticipate an hour, an hour
22 and a few minutes, in the opening summation and a remainder for
23 rebuttal.
24 THE COURT: Do you want me to give you a warning when
25 you're close to the hour?

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1 MR. POLLACK: Or maybe as I cross it. Because I would
2 anticipate -- I would be fine saving 20 minutes for rebuttal, I
3 think. So if I get close to an hour and ten, if your Honor
4 would give me a warning, or Mr. Rakhunov can bang on the walls
5 between us, so that I realize that I have five minutes left or
6 something like that. I would like to stop by an hour and ten
7 to leave some time.
8 THE COURT: I'll give you a five-minute warning when
9 you're coming up on an hour ten.
10 Who's doing the summations for the defendants?
11 MR. HESS: I am, your Honor.
12 THE COURT: Mr. Hess, do you want a warning?
13 MR. HESS: Yes, a five-minute warning will be helpful,
14 your Honor.
15 THE COURT: You're both going to get a five-minute
16 warning.
17 Anything before we start, Mr. Pollack?
18 MR. POLLACK: No, your Honor.
19 THE COURT: Mr. Hess?
20 MR. HESS: No, your Honor.
21 THE COURT: Okay. Mr. Pollack, you've got your track
22 shoes on.
23 MR. POLLACK: My regular shoes, but I'll try to run in
24 them, your Honor.
25 THE COURT: But don't talk too fast. Remember that

1 the court reporter can't see you.
2 MR. POLLACK: I'm working on breathing along with it
3 to keep the pace.
4 THE COURT: Okay. You have the floor.
5 MR. POLLACK: Thank you.
6 May it please the Court, counsel. When I stood in
7 court for the opening statements in this case, I explained that
8 the evidence would show: First, that Mr. Swets, Mr. Baqar, and
9 others at Kingsway have distanced themselves from their key
10 roles and knowledge in the CMC Industries and the TRT LeaseCo
11 deal at issue here; second, that the evidence would show they
12 distanced themselves from proper corporate formalities; third,
13 that they distanced themselves from a clear promise of "not
14 less than quarterly" service fees payable to Plaintiff DGI-BNSF
15 Corp.; and, fourth, how Kingsway has distanced themselves from
16 Mr. Swets, Mr. Baqar, Mr. Hickey more recently, and the
17 documents that those individuals wrote and received years ago;
18 fifth, and perhaps most telling, we said the evidence would
19 show that Mr. Swets wrote to one of DGI's principals a couple
20 of weeks before the parties signed the deal documents stating,
21 "Can't figure out how to solve it, other than 'trust us.'"
22 Just as predicted, Mr. Swets and Kingsway have now asked this
23 Court, through TRT as the defendant, to trust them. The
24 evidence has shown, however, exactly what we said it would and
25 more and why this Court should not trust the positions of

1 Kingsway in this matter.
2 The way I plan to address this closing is to break it
3 up into nine categories: First, going over what is not in
4 dispute; second, to address how DGI's and CRIC's key positions
5 inform the legitimacy of the transaction at issue here, while
6 Kingsway's position, if adopted, would tend to create issues
7 with the IRS; third, I'll address DGI's three specific claims
8 and the essential elements of each; fourth, I'm going to
9 provide more of the summary, the categorical summary,
10 introduction to the key evidence; then, fifth, outline a
11 chronology of important events and how they favor DGI; after
12 the chronology, I'll highlight each witness, and just a few
13 things I think your Honor should keep in mind about each
14 witness, and their biases of certain key things about them;
15 seventh, to the extent it hasn't been covered in the
16 chronology, I'll identify other key exhibits and portions of
17 them that are most relevant; eighth, to the extent I haven't
18 already, whether questions from your Honor or otherwise, I'll
19 try to address significant flaws in some of Kingsway's
20 positions; and, finally, ninth, I'm going to address the
21 remedies we seek in this case.
22 So to start off with important items that are not in
23 dispute, perhaps most importantly, the parties actually agree
24 that this deal contemplated 50/50 split of economics. Your
25 Honor has seen it, there is no avoiding it, there are text

1 messages and emails between the principals that reflect the
2 contemplation of a 50/50 split. Mr. Rakhunov has placed up
3 their examples at P15 within text messages, at TRT_11929 and
4 TRT_11951, where the me in that is Mr. Swets, and it does refer
5 to 50/50 splits of economics. In P16, Mr. Krauss' notes, it's
6 taken down a couple of references at DGI_17747 and DGI_17752,
7 this constant theme of 50/50 dynamics, leaving, really, a key
8 issue whether, before splitting economics 50/50, Kingsway gets
9 to make CMC Industries pay dollar-for-dollar for tax savings
10 generated from NOLs. That's even though none of the deal
11 documents, as I go through the evidence, expressly required
12 such payments. So a 50/50 split is not in dispute, only
13 whether NOLs are additionally paid for in terms of the tax
14 savings generated by them.
15 It's important, with that in mind, that there is one
16 other thing not in dispute, and every Kingsway witness admitted
17 it — that the IRS doesn't care whether those NOLs are paid for
18 or whether the tax savings from them are compensated for
19 dollar-for-dollar. When I say Kingsway witnesses, Mr. Swets,
20 Mr. Hickey, and Mr. Hames, I'm not sure Mr. Hutchens touched
21 that as a nontax lawyer, but the key principals at Kingsway all
22 agreed that from the consolidation standpoint, it does not
23 matter whether the subsidiaries have to pay the parent for the
24 use of NOLs. So, in other words, a lack of an expressed
25 obligation to pay for NOLs plays no role in the determination

1 of NOL qualification or whether companies can be consolidated
2 for tax purposes.
3 Now, everybody has agreed, at least in a conclusory
4 way, that the underlying transaction was legitimate, despite
5 this discussion of a 50/50 split of economics when your Honor
6 has heard you needed to have at least 80 percent of control
7 with the party that possesses the NOLs. Despite the lack of a
8 dispute about the validity of the deal, as I organize and
9 present the evidence to the Court, I ask the Court to keep in
10 mind which side's version actually supports the validity of the
11 deal. So you've heard from Mr. Krauss and Mr. Schwartz how DGI
12 says the management services were real, and are real, and would
13 be valued in excess of $20 million, and thereby justify a
14 percentage other than 80/20, the 50/50, by receiving
15 compensation for valuable real management services. But
16 through TRT, Kingsway, and I'll point out a couple of examples
17 as I go through the chronology, tries to downplay the value of
18 those services, such as the guarantee services and the asset
19 management services. And there is an interesting answer or two
20 I'll read from witnesses where it makes clear that Kingsway's
21 position actually plays fast and loose of what the IRS would be
22 concerned about. And, of course, your Honor should interpret
23 the transaction the way that it appears to present the more
24 appropriate course of consolidation.
25 So I said next I'd talk about DGI's claims. We have

1 three claims here, your Honor. One is a declaration concerning
2 contractual rights under the MSA, specifically a declaration
3 that has no obligation for CMC to pay dollar-for-dollar for tax
4 savings, only for actual taxes. The elements of a contract
5 claim, I think everybody would agree with, and it seems that
6 the only thing in dispute, again, is whether the MSA should be
7 interpreted by applying what appears expressly in the third tax
8 allocation agreement in terms of a payment obligation for
9 subsidiaries to make to parents when the NOLs are used for
10 their benefit, or what we would say in the second tax
11 allocation agreement, where there is no express obligation to
12 make that payment, making a key issue in dispute whether the
13 third tax allocation agreement was validly adopted, which, in
14 DGI's view, it was not for a number of reasons I'll explain,
15 including the circumstances surrounding it and even the
16 requirements in the stockholders' agreement, article 3,
17 sub (d), capital K, and also sub (iii) of section 3 of the
18 stockholders' agreement, which prevented Kingsway from making
19 unilateral changes, such as the change from the second to the
20 third tax allocation agreement. I know Kingsway has some
21 things to say about what paragraph 2 in the second tax
22 allocation agreement has to say, I'm going to address that and
23 why. There was much more than housekeeping measures being
24 changed in the third tax allocation agreement.
25 THE COURT: Let me just interrupt you for a second.

1 So your theory is that article 3(d), whatever, of the
2 shareholders' agreement prevented what?
3 MR. POLLACK: Prevented Kingsway from unilaterally
4 changing the tax allocation agreement.
5 THE COURT: You say it was a unilateral change because
6 Mr. Krauss, who was at the meeting, did not vote for it?
7 MR. POLLACK: Among other things, not only did
8 Mr. Krauss and Mr. Schwartz both testify they did not vote for
9 it, but despite the fact that it had already been signed fully
10 on December 8th, eight days before the meeting and 20 days by
11 others before the meeting, the third tax allocation agreement
12 was kept from them, besides which, the only reference in the
13 MSA to what could be done with that tax allocation agreement
14 was as amended from time to time, which every witness has said,
15 to add or delete parties. That's what the as amended from time
16 to time meant, not in a way that could change this. I would
17 say if your Honor looks at the stockholders' agreement,
18 article 3, little (d), sub (i), capital K, that says that the
19 vote of the board is necessary for making any changes to
20 significant tax or accounting policies, and (iii) just below
21 that, within section 3(d), prevents self-dealing without the
22 full board vote. And that's all consistent with Mr. Krauss'
23 notes of the conversation saying debts, liabilities, and
24 obligations cannot be amended without unanimous consent. I
25 don't know that it actually needs unanimous consent, but it

1 needs CRIC's, at least, under the stockholder agreement; it
2 can't be done without them. And, in fact, one of these clauses
3 specifically refers to 90 percent of the vote, which would
4 require CRIC to be in there.
5 The second claim that DGI has is for specific
6 performance. Our position is that Counts One and Two work
7 together, they're not in the alternative. So once your Honor
8 would declare the rights in Count One, Count Two requires the
9 payments to be made, and it would be -- as a practical matter —
10 I'll talk about this more when I discuss remedies — but the
11 escrow agent would essentially be releasing the funds that
12 match the percentage to which DGI is entitled for quarterly
13 service fees. As the funds accrue, the excess cash flow
14 accrues.
15 The third claim is for reformation based on equitable
16 fraud. It's an equitable remedy that is sought. We've cited
17 to case law, and we'll include that, maybe in more detail, in
18 the supplemental proposed findings and conclusions of law, but
19 it's clear that scienter is not a requisite element, even
20 innocent misrepresentations can support reformation when there
21 is a unilateral mistake that results from it.
22 THE COURT: I just read the amended complaint. It's
23 reformation of the MSA. You're not asking for me to just blow
24 up the whole deal and say, based on everything I have heard,
25 there was not a meeting of the minds on the entire deal,

1 everybody go back to status quo --
2 MR. POLLACK: It's interesting that your Honor brings
3 that up, because as the case came in, I thought that if you
4 gave Kingsway the benefit of every doubt -- if you give us the
5 benefit of the doubt and accept the testimony from the
6 principals and the documents that we've shown, I think it
7 appears clear that the agreement should be interpreted -- the
8 MSA should be interpreted the way we say or we should be
9 entitled to reformation for equitable fraud, but if you gave
10 Kingsway the benefit of every doubt, I think, at most, there is
11 just no meeting of the minds. Mr. Krauss has testified that
12 DGI would be willing to return Kingsway to the status quo,
13 which would support rescission, and as I get into the case law
14 a little bit during this summation, there is clearly broad
15 flexibility, the controlling case law here, that says this
16 Court, once equitable powers are called upon for this Court, it
17 has the power to do what equity deems fair and just, not just
18 the specific relief requested. So I think your Honor has
19 broader discretion. But in the complaint, we clearly just ask
20 for the declaration's specific performance, and, if necessary,
21 I think if we win Counts One and Two, you probably don't need
22 to reach Count Three, but if your Honor thinks it's necessary
23 to reform language in order to have the parties achieve what
24 their reasonable expectations were, which presents the Court —
25 as I was going to describe a little bit later — with

1 extraordinary flexibility. The cases include *In Re Feuer*
2 *Transportation*, 295 N.Y. 87, a 1946 case from the New York
3 Court of Appeals, that says it's a general rule in equity that
4 the relief to be administered will be adapted to the exigencies
5 of the case as they exist at the close of the trial.
6 THE COURT: I don't want to take you down this
7 rathole, but just for purposes of your submissions, and this is
8 true for both parties, the parties in this case, something that
9 hasn't been entirely all that clear all the time is TRT and
10 DGI. Kingsway is not a party to this case.
11 MR. POLLACK: True. Though I think it's been
12 represented in this case, and I will get to that at the end,
13 but I think its interests have been fully represented.
14 But I think your Honor can achieve the equities
15 without rescission, but if your Honor reached the point of
16 believing that was the appropriate remedy, for some reason or
17 another, I actually don't think your Honor should get there
18 because I think the other rounds would resolve the equitable
19 issues sufficiently. But it's there for your Honor, should
20 your Honor believe that something needs to be done or explored
21 there.
22 I just added a more recent case that cites to the
23 cases that I was getting to *Frommert v. Becker*, in the Western
24 District of New York, 153 F.Supp.3d 599, 608 to 09, "The
25 general principal behind this concept is that it would be

1 inequitable and unconscientious for a party to insist on
2 holding the benefit of a contract which he has obtained through
3 misrepresentations however innocently made." As the Second
4 Circuit has previously explained, the defendant's inequitable
5 conduct is enough to support reformation when combined with the
6 plaintiff's mistake. So it doesn't have to have fraud with
7 scienter.
8 THE COURT: Okay.
9 MR. POLLACK: I said after going over what those basic
10 claims are, I would go over, categorically, some of the
11 broader-based issues in this case and why we believe your Honor
12 should determine there was no obligation for CMC to pay for the
13 tax savings arising from the use of NOLs here.
14 First, you can accept the testimony of Larry Krauss
15 and Leo Schwartz. They have made clear that the discussions
16 with Mr. Swets and others on behalf of Kingsway and TRT,
17 including Mr. Swets committing to not charging anything for the
18 use of net operating losses in the context of receiving such a
19 large equity interest in a valuable company. They attribute to
20 him discussions of actual taxes and nothing else without
21 unanimous consent.
22 So if you accept that testimony, DGI prevails. Even
23 without taking their testimony at face value, though, there is
24 substantial evidence that shows -- that corroborates them and
25 shows why the deal did not require the payment for tax savings

1 arising from the use of an affiliate's NOLs, only payments of
2 actual out-of-pocket expenses.
3 One, the parties repeatedly and consistently discussed
4 the 50/50 split in writing. And you'll see how the negotiation
5 makes that important, but, of course, your Honor, if you're
6 getting to the point in a deal where, under Kingsway's view, it
7 could be so lopsided, negotiating 50/50 in that setting just
8 wouldn't arise the way you'll see it arise in the text
9 messages, where there are comments of so long as it's 50/50;
10 you'd be more interested in so long as it's X-million. And
11 when your Honor sees the context of the text messages that we
12 have cited to, you'll see the discussions of the 50/50 truly
13 mean what it is, 50/50 economics.
14 Second, none of the deal documents required such a
15 payment for tax savings resulting from net operating losses.
16 We submit there is no credible testimony in the case to the
17 effect that payments for NOLs were ever discussed between the
18 parties during negotiations. In fact, Mr. Hutchens gave a very
19 telling answer — it's on page 58 of day 2 of the trial, at
20 least as the rough came together — that "The discussion was not
21 focused" -- this is the quote -- "The discussion was not
22 focused -- well, I mean, interestingly, the discussion was
23 really focused, you know, more on the sort of things other
24 than, you know, the NOLs and the initial contributions.
25 Everybody knew, right, that those were the anticipated items,

1 right? The initial capital contribution of $1.5 million and
2 the value of the NOLs that KFS was bringing to the table, that
3 was undisputed in terms of that those counted and those applied
4 as a deduct from what the dollar amount is going to be before
5 you applied this multiplier. The discussion was about the fact
6 that, you know, we also wanted to account for unknown items,
7 right? What if you put more money in or what if there are
8 other loans that have to go in place and that sort of things."
9 So, Mr. Hutchens is actually saying everybody knew, so we
10 didn't have to talk about it.
11 Other witnesses, Mr. Hickey and Mr. Hames, said they
12 were never on those discussions to have those sort of talks or
13 be involved with it. Mr. Swets, particularly, towards the end
14 of his cross examination, admitted he didn't remember any
15 specific conversation with any specific person and talked in
16 generalities. I submit, your Honor, in response to questions
17 by me and by the Court, he would give answers that talked about
18 taxes in a way that seemed like it was actual taxes. So I
19 think it's easy for your Honor to say -- and let's remember,
20 later in the case, your Honor saw it wasn't until April 15th
21 that the tax allocation agreement language gets inserted into
22 the -- and I have more to say about this -- gets inserted into
23 the contribution liability satisfaction amount — I'll refer to
24 that as the CLSA going forward — which Kingsway calls the
25 waterfall here. But before that, it just said inclusive of

1 taxes. Not tax savings, not NOLs, inclusive of taxes.
2 If you remember, that changed in the MSA from
3 inclusive of taxes in the CLSA definition to including a
4 reference to the tax allocation agreement came eight days after
5 Mr. Hames makes the significant tax observation, he's on the
6 privilege log with that, and as well with the important tax
7 observation or amendment to the MSA. There are no projections
8 in the record before April 14th, 2016, and what you see happen
9 on April 15th is that Mr. Swets starts purchasing Kingsway
10 stock. This deal, that change to the MSA, and then he goes and
11 buys, I think it's, 11,000 shares between April 15th and the
12 announcement on May 17th of the transaction in a way that gives
13 him a significant financial incentive, and I don't even
14 understand how there could have been a window, as your Honor
15 looks at the Form 4s, that would have allowed him, as a
16 fiduciary of Kingsway, to make those purchases. And you can
17 see the way they fluctuate, it's not due to a predetermined
18 plan to buy or sell.
19 The next important point that shows categorically why
20 my clients are right, or DGI is right, about there not being an
21 obligation to pay dollar-for-dollar for the use of NOLs is that
22 at the time of the transaction, Kingsway had more than
23 $800 million in NOLs and a business that continued and
24 continues to lose money, leaving it little or no use for those
25 NOLs. As of that time period, it was not even tapping into

1 historic NOLs. I don't think with what's in evidence, your
2 Honor, there is any evidence that more than present operating
3 losses have been sufficient to set off any income from CMC.
4 So, Kingsway is sitting on this trove of NOLs that it has no
5 use for, and I understood your Honor's comments during the
6 trial that things that could happen 17 years down the road may
7 not, with many public companies, be something that would change
8 the value of stock or that would greatly affect the view of
9 stockholders, but you do have Mr. Stilwell here -- and I'll
10 have a little more to say about him -- who owns -- he started
11 buying up more of the company, if you remember. He had been on
12 the audit committee, and then he was barred from associating
13 with an investment adviser for a year, from March 2015 to March
14 2016. He comes back, within a few weeks, the deal is changed
15 in the definition of the CLSA. At the time it closes, he sends
16 the big congratulations message to Mr. Swets. But for him
17 personally, we heard the testimony, he went from 20-percent to
18 a 25-percent ownership. Mr. Hickey testified to that, he was
19 buying it up. And it literally means that where this asset,
20 these NOLs, that are listed in the SEC filings as the primary
21 asset of the business have no value to him unless they actually
22 get used, and that's why it's an important message from Larry
23 Swets to him saying, we've got this phantom income, where it
24 becomes much more valuable to them when there is income coming
25 in that's going to be paying dollar-for-dollar. So

1 Mr. Stilwell had a very important interest in seeing those paid
2 for dollar-for-dollar. I mean, if you accept Kingsway's now
3 view of the world in this case, Mr. Stilwell benefits
4 personally by over $20 million. It's just a big incentive.
5 And this is the person who went from the audit committee to the
6 compensation committee by the time Mr. Swets is writing to him
7 with the comments about now having, I think the words are, a
8 crapload of rail yards and some phantom income, and he gets the
9 big congratulations back.
10 The next categorical point of why DGI is right is the
11 subsequent unilateral amendments to the second tax allocation
12 agreement. Mr. Rakhunov is going to put up P11. I ask your
13 Honor to keep in mind, nobody was showing any of our people a
14 redline, let alone showing them even the agreement at the
15 December 16th, 2016 meeting.
16 If your Honor remembers, Mr. Baqar represented, as an
17 officer of CMC and TRT, that new obligations were just
18 housekeeping measures to add and delete entities and to
19 clarify, to make clarifying edits. Expressly, supposedly
20 nothing that would impact CMC. The Court has seen exhibits,
21 however, where Mr. Swets and Mr. Baqar actually plot to avoid
22 giving documents to Mr. Krauss and Mr. Schwartz early. Even
23 the resolutions themselves were not sent by direction of
24 Mr. Swets until 10:00 a.m. Central Time or 11:00 a.m. Eastern
25 Time before a midday meeting of the board. The third tax

1 allocation agreement, even in draft form, wasn't available at
2 the meeting or before the meeting for Mr. Krauss and
3 Mr. Schwartz, and now we know it was actually signed
4 December 1st and in existence as far back as November 18th,
5 when it was being presented to insurance regulators by
6 Mr. Hames. So there is no excuse for it not getting before
7 Mr. Krauss and Mr. Schwartz, and you do have both of them
8 testifying they were silent. They were participating by phone.
9 We have had Mr. Hickey say those minutes are wrong, but he
10 wasn't even there. But I'm not exactly sure on the telephonic
11 vote of ayes, that silence could be taken as reliable. And
12 besides, your Honor, even if someone thought they heard an echo
13 on the phone that was Mr. Krauss or Mr. Schwartz saying aye,
14 the actual third tax allocation agreement was being presented
15 by a fiduciary as just housekeeping changes to add or delete
16 parties and make clarifying edits, nothing of substance.
17 THE COURT: The only evidence that Mr. Krauss voted in
18 favor of is the minutes, correct?
19 MR. POLLACK: That is no one who attended that meeting
20 has said Mr. Krauss or Mr. Schwartz voted that way. In fact,
21 Mr. Krauss, Mr. Schwartz, and consistent with Mr. Pecci, said
22 this was a surprise. You do see the minutes have Mr. Pecci
23 start off asking for a copy of it, and it's not made available.
24 The minutes actually acknowledge that. I'm actually in some
25 way surprised they acknowledge that, but they acknowledge that

1 and then call it a unanimous vote when there is just no way
2 that's consistent with what was going on at the time.
3 And what do you see just before that meeting? You see
4 P54, where that's Mr. Swets' instructions to Mr. Baqar to send
5 the documents at 10:00 a.m. the next day, Central Time. P43 is
6 Mr. Swets reaching out to Mr. Stilwell, the head of the comp
7 committee, who has had his own issues, trying to get him to
8 give five to ten minutes of background before that meeting
9 starts, where Mr. Stilwell, according to the minutes, says,
10 let's vote on these items one at a time. P41 is the one that
11 says we are heavily advised by counsel. And while these
12 messages are going to Mr. Stilwell about being heavily lawyered
13 up, remember Mr. Swets, at the same time, if you look at the
14 text messages, these simultaneous text messages, of
15 Mr. Schwartz that's saying this is a complicated deal. If you
16 look at these emails on 12/14 and 12/16 and compare it to the
17 text messages of 12/14 and 12/16, you will see dishonesty, your
18 Honor. You will see very different approaches on what's being
19 done, and that, as I'll get into just a little bit more later,
20 followed the first meeting between Mr. Swets and Mr. Schwartz
21 on November 16th, the first time they meet in person. If you
22 remember, November 3rd, they're supposed to meet. Mr. Swets
23 leaves Mr. Schwartz in an airport, essentially, while he goes
24 to a baseball game. They get together a couple of weeks later.
25 And this is like the sort of evil brilliance in kids' cartoons,

1 of Mr. Swets getting Mr. Schwartz to propose an amendment to
2 the MSA. And that's clearly -- if you look in the text
3 messages and the emails that followed, Mr. Swets is expressing,
4 I want to work with you, we're going to figure this out, I have
5 solutions. As Mr. Schwartz said, he's the solution guy, and
6 you see this in his texts. But he's also saying, get us that
7 proposal for the change to the MSA, but what's the evil
8 brilliance of that? It's building a record to have
9 Mr. Schwartz sort of give the impression, we need a change to
10 the MSA, while Mr. Swets is sort of giving Mr. Schwartz the
11 position he's aligned with him. And that follows things like
12 the tax guys are giving me trouble and the other comments where
13 he's trying to say, I want to get this done, we'll figure it
14 out, propose a change to the MSA, we'll go from there, and then
15 once he gets that, Mr. Swets kicks into, well, let's get the
16 lease amendment done -- he doesn't say this, but that's because
17 that starts putting more immediate money into Kingsway's
18 accounts if Mr. Swets is allowed to carry through on the view
19 of the MSA that allows them to charge dollar-for-dollar along
20 the way.
21 THE COURT: Back up, Mr. Pollack. I think I got lost
22 at some point.
23 MR. POLLACK: Okay.
24 THE COURT: When is Mr. Swets saying -- the question
25 is: When did Krauss and Schwartz first figure out that we have

1 a problem, Houston, we have a problem?
2 MR. POLLACK: The evidence is towards late November,
3 they get guarded when there are projections starting to be
4 shared that suggest they don't get what they expected to get.
5 THE COURT: What projections were shared with them?
6 MR. POLLACK: I don't have the exhibit number handy
7 now, your Honor. I may end up getting to it later in the
8 presentation, but, actually, I think that gets sent over in
9 December. It's being produced inside, internally, from
10 Mr. Swets — I may have misspoken — and then it's shared in
11 December before the December 16th meeting, and they realize
12 something is not going the way -- "they," meaning Schwartz and
13 Krauss, realize something is not going right. November 16th,
14 Mr. Schwartz has some idea because Mr. Swets is starting to
15 tell him, when you look at the text messages, this is
16 complicated, and they get together, and he's saying, you're
17 going to have to propose an amendment to the MSA, so we can get
18 this done based on what my people are telling me.
19 THE COURT: I guess what I'm pushing on is what was
20 the trigger for that as between Schwartz and Swets? Why were
21 they -- I guess --
22 MR. POLLACK: I think I can give this to you, your
23 Honor, and I think it would come through when I got to the
24 chronology, but October 24th is the internal email where
25 Mr. Swets says, hey, they're looking to finalize a deal with

1 BNSF. I know CRIC obviously wants to do this because it
2 gets -- he says 75/25, I think he meant 80/20, on the front
3 end, but if it means they get 80/20 on the back end, I'm not
4 going to approve this. If you remember, Mr. Swets had that
5 distorted set of answers, like, oh, I was doing exactly what
6 Mr. Schwartz told me, but when you read the email, that's not
7 what was going on.
8 THE COURT: So, basically, it sounds to me like when
9 people started to figure out they've got a problem is when the
10 plaintiffs were pushing on doing the BNSF lease amendment,
11 Swets is having his people run the numbers, and that's where
12 they start -- at least Swets starts to figure out, if he didn't
13 already know, that this was giving the CRIC folks nothing.
14 MR. POLLACK: I think Swets very much already knew
15 what kinds of positions would be taken, your Honor. But if you
16 remember, when they signed, there was a chance they weren't
17 going to face any of these issues for 17 years. If BNSF did
18 not go forward with something, all these issues that are before
19 your Honor now, could you imagine if they were getting
20 presented 17 years later. Maybe your Honor would prefer that
21 in a way, maybe it feels like it's been 17 years of trial, but
22 we're still far away from the 17 years, however long this trial
23 has taken.
24 So the issue might never have had to be addressed
25 until somewhere late in 2034. Parties, at a more advanced age,

1 would have been fighting over how you divvy things up. So, in
2 that sense, it gets back to that cartoon evil genius that is
3 setting something up then, but it's being forced, the issue is
4 being forced, by the BNSF lease amendment, and you see what --
5 even then, Mr. Swets, I think, knew what he had teed up for the
6 back end, but he didn't realize, at least when he sent his
7 October 24th email, that the position he and his folks would
8 take would also hurt DGI in the front-end. And, of course,
9 what doesn't make any sense about that is, why would
10 Mr. Schwartz even begin to negotiate a lease amendment that
11 would mean DGI would get nothing. And I say that because,
12 under Kingsway's view of the deal, the only way that DGI and
13 CRIC get anything meaningful is if there is a sale for an
14 extremely large amount, whether 200, 300 million dollars.
15 That's possible, that could happen then, but not now, not now,
16 in all likelihood, with a $25-million option to buy something
17 at 150, because if the value of the real estate gets that high,
18 who's going to buy and sell it.
19 But Mr. Schwartz would never, and Mr. Krauss would
20 never have been with him, creating the lease amendment that
21 gets them nothing and takes even the upside of a $250-million
22 sale off the table for them. It just wouldn't make any sense.
23 And you see what's greeted. So at that point, I think
24 Mr. Swets didn't realize the full potential of what they did by
25 inserting tax allocation agreement into the definition of CLSA,

1 that by taking the position they're taking now, they would be
2 able to foreclose any of those quarterly service fee payments
3 that were promised as the lease amendment came in. In fact,
4 what do they do to cement that position, Mr. Swets meets with
5 Mr. Schwartz on November 16th, as this issue is starting to
6 come to a head. Between October 24th and November 16th, there
7 are projections being run, there are some discussions where
8 Mr. Swets, by text, your Honor will see, is saying things like
9 they're not contesting the 80 percent, it's just priority of
10 payment when he refers to his people, but I'm with you, we'll
11 find a solution, we'll get you something. He meets with him
12 November 16th, pushes Mr. Schwartz to propose an amendment to
13 the MSA, while two days later, they sent to an insurance
14 regulator a new third tax allocation agreement that adds
15 paragraph 5. And no matter how many times Mr. Hames makes
16 himself sound like someone who just completes and files forms,
17 and no matter how many times Mr. Hames says, well, it wasn't
18 because of the CMC Industries transaction, he identified no
19 business reason for mending with the new paragraph 5. And it's
20 not only in new paragraph 5.
21 Mr. Rakhunov, if you can go back to P11, the redline.
22 It's not only paragraph 5, which adds, as Kingsway
23 witnesses have had to admit, the first express obligation of
24 the subsidiary to pay the parent, but in paragraph 4, it takes
25 out any overpayment of estimated tax shall be refunded to the

1 subsidiary. And when your Honor reviews paragraph 4, it
2 contemplated — it didn't require, but it contemplated —
3 estimated tax payments if Kingsway was making estimated tax
4 payments, but then promised the subsidiary a refund, which
5 would mean there is a contractual obligation for the subsidiary
6 to get its money back, even if the subsidiary had a separate
7 tax return liability. So that even if the subsidiary was
8 profitable, so that it was paying some share of estimated
9 taxes, if at the end of the day, Kingsway didn't have any tax
10 liability, that statement they take out, the penultimate
11 sentence of the old paragraph -- I guess it was the old
12 paragraph 3 that became paragraph 4 in the third, and then that
13 sentence was taken out, this was an entirely different tax
14 allocation agreement. It's a material change that any
15 overpayment of estimated tax shall be refunded to the
16 subsidiary. It doesn't say any overpayment of estimated tax
17 shall be refunded to the extent it is more than the separate
18 return tax liability. This was a very different tax allocation
19 agreement before December 16th or before December 1st,
20 depending on when you consider it signed, because Hassan Baqar
21 signed it on December 1st, before he was even an officer of
22 CMC, because he was appointed an officer on December 16th.
23 Corporate formalities were not a part of any of this, because
24 what they were doing was putting $25 million or so into
25 Mr. Stilwell's pocket.

1 So the next thing I would say, categorically, that
2 makes DGI correct in its position is, your Honor, all the false
3 denials by Mr. Swets. They reflect his consciousness of guilt
4 and the lack of any agreed-upon obligation to pay Kingsway the
5 very tax savings that DGI and CRIC sought to avoid paying the
6 tax authorities. Remember, Swets admits, and it's in
7 Mr. Krauss' notes, that he makes a comment about would have
8 never done such a win-lose deal if he realized it.
9 THE COURT: Who said that?
10 MR. POLLACK: Mr. Swets actually says that — he never
11 would have done, gone forward, with such a win-lose deal in
12 Kingsway's favor. That's not -- and he claimed that he made a
13 $180-million error, and that's reflected both in Mr. Krauss'
14 notes in P16, as well as in text messages without the numbers.
15 So he didn't put the $180-million error into his text, but the
16 message is conveyed to Mr. Schwartz about the inside tax basis
17 issue. No other Kingsway witness supports Mr. Swets on that,
18 that he somehow, oh, we made a mistake, and it really hurts our
19 partner. In fact, they admit Kingsway was trying to strike the
20 best deal it could for itself. These were ways that Mr. Swets
21 was trying to keep Mr. Schwartz and Mr. Krauss at bay as long
22 as he could.
23 And I'd finally say, categorically, the corporate
24 culture at Kingsway means something here in terms of who to
25 believe, DGI or Kingsway/TRT. Remember, Mr. Stilwell, who

1 becomes the big player here, he's the largest shareholder, he
2 had been barred for a year, up until March 2016, by the SEC
3 from associating even with the investment advisory portions of
4 Kingsway. He comes back, and then a few weeks later, the
5 nature of this deal changes. You heard testimony from
6 Mr. Hickey that, even as compromises were being discussed with
7 Mr. Swets, Mr. Stilwell never approved any of them. And,
8 remember, Mr. Stilwell went from the chair of the audit
9 committee before his bar to chair of the comp committee
10 afterwards, which made him very important to Mr. Swets and for
11 Mr. Swets to please. And, of course, the Form 4 show
12 Mr. Swets' suspicious trading activity, there's no way to look
13 at it other than inside trading.
14 Now I'm up to the chronology of events, your Honor,
15 which gives you another chance to see some of the important
16 events and how they fit together.
17 The first thing is the letter of intent in January
18 2016, which your Honor will recall had a $20-million strike
19 price. Kingsway witnesses all say, Mr. Swets included, that
20 that $20 million was designed to estimate a payment for the net
21 operating losses. If you remember, the testimony was, it
22 started at $40 million, it got negotiated down to $20 million.
23 Mr. Schwartz saw it. If you present-valued it, you took off
24 the $1.5 million, which it's up on the screen, your Honor, in
25 P61. There was no return of that $1.5 million at that point.

1 That $1.5 million was a purchase price, and then there's a
2 $20-million strike price going back.
3 THE COURT: I'm sorry, what's the date of this?
4 MR. POLLACK: If you scroll up, Mr. Rakhunov.
5 I think it's signed February 1st, but it has a late
6 January date, is my recollection. I see a February 2nd
7 signature by one of them; the other signature is not dated.
8 THE COURT: I'm just trying to get the month, just so
9 the chronology works.
10 MR. POLLACK: So it's put together at the end of
11 January, it's dated January 30th, it's fully signed by
12 February 2nd.
13 THE COURT: And all of the evidence, as I recall, is
14 that this was Swets. Swets was the guy who put together this
15 letter of intent. Nobody else sort of disclaimed any knowledge
16 or participation.
17 MR. POLLACK: Even if Mr. Dochter participated in it,
18 Mr. Swets has testified Mr. Dochter didn't really know what he
19 was doing. But it's coming from the Swets end, possibly with
20 Dochter helping him in some way.
21 Kingsway wants to say that this shows DGI always
22 planned to compensate Kingsway for NOLs and tax savings
23 separate from the equity interest. What witnesses have
24 actually agreed on, and it's somewhat incomprehensible how this
25 doesn't put an end to the issue, particularly if you want to

1 look at this transaction as legitimate in the eyes of the IRS,
2 but the first set of stock purchase agreements still had -- the
3 first three, I think, still had the $20-million stock strike
4 price, but it also had the tax allocation agreement in it as
5 well. Mr. Hutchens was very clear. He didn't want this to
6 look like they ever intended to double bill. That's when he,
7 all of a sudden, says, well, these are early drafts, that was
8 going to get cured, you wouldn't pay both the $20 million plus
9 pay dollar-for-dollar for tax savings under the tax allocation
10 agreement. He testified very clearly to that effect. But he
11 also gave an answer that was even more important, and this is
12 on page 143 to 144 of day 2, he said when it switched to the
13 management services agreement -- the question was, Mr. Hutchens
14 had just described the services being added, and I read it
15 earlier about something the IRS could accept, and he was asked:
16 "So these services replace the $20-million strike price,
17 correct?" And he answered: "Effectively, yes." And, of
18 course, that's what it was. You have a valuable guarantee, a
19 valuable asset management service. The board services weren't
20 as material, but those two parts of it were real, and are real,
21 and it involved real services.
22 And, in fact, your Honor, if you take the answer
23 Mr. Hutchens gave just before that, only by having those
24 services be real is consolidation justifiable because to get
25 DGI compensation that gets you to 50/50 economics overall,

1 those services need to be real, and what do we see? We see
2 internally an estimate of $6.8 million for the guarantee, well
3 above what any projections say by itself DGI gets, and then,
4 for asset management services, you've heard Mr. Krauss testify
5 that he'd expect those to be half to 1 percent, which would be
6 even larger than 6.8.
7 And, importantly here, the $1.5 million changes in the
8 management services agreement. Now it goes back first, where
9 it never went back in the letter of intent. So when they were
10 negotiating a change, some substantial things happened going
11 from the strike price. The $20 million was replaced with
12 valuable services, a valuable guarantee worth either
13 $6.8 million, as it's stated in the management services
14 agreement, or at least 12 to 13 million, as Mr. Krauss said
15 what's usually charged for that, and then comparable charges
16 for the asset management services, plus 1.5 goes back to
17 Kingsway as part of the changes from the letter of intent.
18 Well, now you get back to the situation where Mr. Hutchens
19 would be saying this is a double billing, that never would
20 occur because now, unlike in the letter of intent, DGI is
21 performing these valuable services, and Kingsway has taken the
22 position it needs to pay dollar-for-dollar, which ends up --
23 since the management services replaced the $20-million strike
24 price, that would do away with the -- that matches up to the
25 $20 million, by their own testimony, making any attempt to

1 charge more double billing -- I just want your Honor to please
2 look at that April 15th change, where before that, it always
3 said inclusive of taxes. Mr. Hames can say, I always thought
4 about it the same way. It didn't change to me, so I didn't
5 think it was anything significant because inclusive of taxes,
6 to me Mr. Hames means tax savings, too. But inclusive of taxes
7 means inclusive of taxes. Not inclusive of taxes didn't even
8 reference the tax allocation agreement there.
9 And if you look at Mr. Krauss' notes at the time, the
10 front of P16, Mr. Krauss' notes starts off -- and I suspect
11 Kingsway is going to try to make something out of a referenced
12 NOLs at the very beginning, but if your Honor looks at these
13 notes in P16, very important here, and it actually hasn't been
14 said by witnesses, but you can see it, this first part of the
15 discussion on the first page is about the stock purchase
16 agreement. You'll see section after section about the stock
17 purchase agreement when there is a discussion about the value
18 of NOLs, because if you look at the stock purchase agreement,
19 it would look like Kingsway is just buying this entity for
20 $1.5 million, when, obviously, to DGI and Mr. Krauss, the
21 purchase isn't just about $1.5 million, it's about coming in
22 with the NOLs, and that kind of discussion flows in the
23 discussion of the stock purchase agreement on this first page.
24 The MSA discussion during that meeting doesn't occur until it
25 says MSA, and then you get right back to the 50/50 discussion

1 and how you get to 50/50. Not how you get to 50/50 over some
2 small remainder after we now charge you more than what's,
3 quote, inclusive of taxes, which is what had been in the
4 agreements until that day when the new agreements went over, as
5 your Honor saw, 10:29:26, before the start of a 10:30 call that
6 morning.

7 But, in fairness, even when they looked at the second
8 tax allocation agreement, it has no obligation to pay, the
9 subsidiary to pay, the way the third does. The best way to see
10 that is to look at the third, but I will also say that
11 Mr. Willens' testimony is uncontradicted. Their expert only
12 reads in a regulation, doesn't say what is owed, and the MSA
13 talks about obligations actually owed, not just a separate
14 return tax liability that's created as a matter of
15 apportionment, which was explained to your Honor, the IRS
16 doesn't care whether that's owed or not, and the second tax
17 allocation agreement didn't make it owed. And no matter how
18 many times Mr. Hames brings up 1347 Property Insurance
19 Holdings, which is also Maison Insurance, until we were able to
20 go through all the public filings of Maison Insurance, they
21 were portraying that as something done under the second tax
22 allocation agreement, when, in fact, by then, there had been
23 releases from that, those payments were actually made for old
24 expenses and expenses under the transition services agreement,
25 which is in evidence, and only a year-plus later, after there

1 are full releases in a buyout, does Mr. Hames, as the vice
2 president of tax, find a favorable way to treat payments under
3 a transition services agreement as a prepayment of tax. It
4 gave them more favorable tax treatment to call it a prepayment
5 of tax liability over a compensatory payment for transition
6 services, and that was Mr. Hames' job. And to the extent he
7 denies it and wants to talk about how the memo I showed him,
8 which was P22, that he drafted, the single-spaced 16-page-or-so
9 memo about tax strategies, that's not his job, your Honor. He
10 just files tax returns. He says, well, that isn't even the
11 final one, my strategy wasn't adopted, but BDO only produced
12 that one. At first, he said he didn't even give that to BDO,
13 then he acknowledged he gave it to BDO, as it had a BDO Bates
14 stamp on it, and Kingsway didn't or TRT didn't even produce
15 that, we had to go out to BDO to get it. He's a tax
16 strategist. His job, as vice president of taxes at an entity
17 like Kingsway, was to save the taxes.
18 Your Honor, after the December 16th meeting, what your
19 Honor starts to see are emails by Mr. Hickey, where he refers
20 to our, quote, our interpretation of the MSA, very interesting
21 language.
22 THE COURT: When did that start?
23 MR. POLLACK: I believe it's December 20th and then,
24 again, in the first week of January. I know I have, as I go
25 through the exhibits — Mr. Rakhunov has it up — P54 on

1 December 20th, by applying our interpretation of the MSA,
2 Leo/service provider would be projected to receive zero
3 dollars. And then in January, early January, he uses that
4 phrase again, not under the MSA, and he's not even involved
5 directly in the discussions with Mr. Schwartz, but they know
6 what they've done, they know that they have amended the tax
7 allocation agreement to include a payment obligation. They
8 know, from all that flurry of activity between April 7th and
9 April 15th, that they changed inclusive of taxes to include
10 obligations owed to Kingsway under the tax allocation
11 agreement. Not owed under a transition services agreement, not
12 owed because of some other buyout agreement and release that
13 affects 1347, but the tax allocation agreement where it was not
14 owed under the second, but it was owed -- it would be, I think,
15 owed under the third, if that had been validly adopted, your
16 Honor, but for all the reasons I've said, it was not and never
17 was under either the stockholders' agreement or the actual
18 facts of what happened at that meeting.
19 So what you see after these references to our
20 interpretation, our effort to compromise. And I do think your
21 Honor shouldn't consider the specific offers that go
22 back-and-forth, I was clear on that from day 1, that there are
23 ways those things shouldn't be used. What it could be used for
24 is for your Honor to see that Mr. Swets was trying to get the
25 lease enhancement done before -- by holding out from

1 Mr. Schwartz the possibility of an MSA amendment. And then
2 when there is an effort to say to Mr. Swets, well, you'd said
3 there would be this MSA amendment, you told me to propose one,
4 why isn't anybody doing it, they're going to say that's
5 Mr. Schwartz trying to exert something before the lease
6 enhancement. But if you follow where it goes along, you'll see
7 Mr. Swets promoted the idea of an MSA amendment to get
8 Mr. Schwartz going in that direction in all the ways that could
9 help Kingsway in arguments later, but then strings DGI and
10 Mr. Schwartz along with the idea that there will be solutions.
11 The key exhibits, we've looked at P61, which is the
12 letter of intent.
13 D28 is the initial draft of the SPA, and I think
14 that's important because you'll see that, and the first three
15 drafts of the SPA actually have both the reference to a
16 $20-million strike price, as well as a condition of closing of
17 entry into the tax allocation agreement, which Mr. Hutchens
18 made clear would never have survived because we wouldn't charge
19 you twice, but we are going to try to charge you twice when we
20 replace the $20-million strike price with management services.
21 He doesn't actually say that, but that's essentially how his
22 position has morphed at trial, but, yet, can't identify any
23 actual discussions that support that, your Honor. And it is an
24 important aspect of contract law, that unexpressed
25 understandings are meaningless unless both sides share the same

1 unexpressed understanding, otherwise it plays no role in how a
2 contract should be interpreted.
3 D5 ended up important. While the defendants put it in
4 for one purpose, here is a moment, a passing, unguarded moment
5 of truth in a clause where Mr. Swets is trying to save Kingsway
6 a few hundred thousand dollars with Mr. Dochter. Given the
7 difficulty in Terracap's willingness to agree to our original
8 understanding on structure, that is what Mr. Krauss said, that
9 he was not willing to have DGI or CRIC pay a $20-million strike
10 price here, but they were willing to give management services.
11 That's consistent with this. And you remember Mr. Swets fought
12 this. He didn't even know who Terracap was for a while until
13 he saw an email that had Mr. Krauss labeled with Terracap, and
14 then he acknowledged that is Mr. Krauss. I'd say that Kingsway
15 may try to point to another part of this email that talks about
16 Kingsway getting 100 percent value. Putting aside that that's
17 not admissible for -- this statement that we're relying on
18 comes from Mr. Swets himself. They're trying to introduce
19 something from Mr. Dochter in this email, which is not
20 admissible for the truth of the matter asserted, but I'd say,
21 even more so, it actually tends to prove our version of events
22 because if you accept Kingsway's version, they're getting paid
23 nearly 190 percent on their NOLs under their view of things.
24 Not 100 percent. It's actually only if you look at the deal
25 the way we say it is, that it's closer to what Mr. Dochter

1 might call 100 percent value on the back end, but on the back
2 end. But at any rate, that was hearsay. Your Honor did not
3 accept that statement. But I just wanted to explain that the
4 100 percent value by Mr. Dochter, particularly combined with
5 how Mr. Swets described it, doesn't help Kingsway's position at
6 all.
7 P16, I've already talked about, that's the April 15th
8 call. And I just want to remind your Honor to view the
9 sections that are being discussed at the beginning, it's all
10 the stock purchase agreement. And when they try to take that
11 first line there to say, well, there is some discussion about
12 NOLs at the top of the page, that's in connection with
13 discussions about the stock purchase agreement, which they
14 discussed first. It's not until the second or third page where
15 they start discussing the MSA.
16 P132 are the Form 4s. It shows 11,334 shares of
17 Kingsway stock purchased by Mr. Swets.
18 THE COURT: I don't really know what to make of that.
19 Again, if this was something that was going to pay off
20 immediately, I totally agree with you that that's evidence of
21 consciousness of guilt, but at best, this was -- unless they
22 were going to recognize the revenue, and the recognition of the
23 revenue was going to be beneficial to them. I'm just at a loss
24 to see --
25 MR. POLLACK: They did, your Honor. They changed

1 their allowances in their SEC filings. And they heard from
2 stockholders along with that announcement. Remember, there are
3 two emails from stockholders essentially congratulating or
4 commending Swets -- remember the one he answered, yup, that's
5 one stockholder who's doing it, and he's also pleasing
6 Mr. Stilwell, who's buying up more and more stock, but he did
7 make money on this, Mr. Swets. He just did. That's a fact.
8 This is more like a penny stock, your Honor. You can see what
9 it's trading at there, at $4 and change. I'm hoping it's in
10 the record somewhere. I didn't put it in as such, but it got
11 up to $6, and I withdraw that comment if it's not supported by
12 a later document, but I'm hoping in some of the SEC filings,
13 your Honor can see that. But even without that, your Honor can
14 see that in a stock trading at this kind of price, making the
15 announcement they made on May 17th, which is a whole new way to
16 use what's labeled as their primary asset. And then recall
17 they were found by BDO to have internal control issues over
18 their tax accounting on the CMC deal, but they actually improve
19 their allowances by $90 million. And I took Mr. Hames through
20 that testimony between the annual filing for 2016 versus 2017,
21 so they showed a major improvement there. Whether or not they
22 were allowed to do that in the long run, whatever BDO said
23 before it resigned, they did get the benefit of that change in
24 allowance in their SEC filing.
25 On May 2nd, 2016, P36, that's when Mr. Swets says, in

1 the middle of this buying spree of stock, can't figure out how
2 to solve it other than trust us. Your Honor has seen enough
3 cases to think about which people tend to say just trust me.
4 And that's what Swets is saying there, just trust us, don't
5 change documents, we can't figure that out exactly, but we're
6 going to solve it for you.
7 P145 is the big congratulations from Mr. Stilwell
8 following Swets' comment. Tellingly, it doesn't even say CMC
9 here, your Honor, though this big investor knows exactly what
10 it is, all aboard, we now own a crapload of acres with lots of
11 rail cars, and some phantom income. And as Stilwell and
12 Mr. Swets had plotted, that meant $20 million down the road for
13 Mr. Stilwell and some increases that Mr. Swets could enjoy more
14 immediately, including in his compensation. Remember that
15 Mr. Stilwell rarely sat on boards — that's what Mr. Hickey
16 said — but he did sit on the CMC board because it had such
17 potential value to Mr. Stilwell, literally as growing into a
18 25-percent owner.
19 P38 is the October 24, 2016 email. It's Mr. Swets
20 saying he didn't want to approve the lease amendment if that
21 meant they got the big share of the back end. And he sets his
22 team running.
23 P15 goes to November 12th, 2016. This is on
24 TRT_11956. It's a text message where Mr. Swets is saying, what
25 a complicated deal. Did you know there is no inside tax basis?

1 Fortunately, my team anticipated this. If you remember,
2 Mr. Hickey testified, in no uncertain terms, that no later than
3 June, he spent time convincing Mr. Bates to agree for DGI that
4 there was no inside tax basis. That's how Mr. Hickey framed
5 it. Mr. Hames tried to distinguish between an inside basis,
6 and the assets, and the land, but then admitted the land was
7 very small. Remember, they saw balance sheets, your Honor.
8 They knew, at least, that the inside basis was extremely low
9 throughout, and they had access to all these materials, but
10 what Mr. Swets couldn't keep straight was exactly what he was
11 saying who knew when. So there is a later time in these text
12 messages when he actually tries to claim none of us knew that
13 there was -- and I'm jumping ahead a little bit -- but that
14 none of us knew there was any inside basis in this property
15 after he had actually acknowledged, and, of course, Mr. Hickey
16 and Mr. Hames say they knew by June, before closing, when they
17 actually knew earlier as they came in possession of balance
18 sheets and other financial information.
19 P41 and P43 show an advance of the December 16th board
20 meeting, the efforts to be heavily lawyered and to plot how
21 they were going to put this through without showing the third
22 tax allocation agreement itself, how they were going to get the
23 resolution to Mr. Krauss and Mr. Schwartz very late. And you
24 see, I've gone over the comments by Mr. Hickey after that board
25 meeting about our interpretation of the MSA after they

1 radically changed the third tax allocation agreement.
2 P51, that's June 8th, 2017. That's when Mr. Swets and
3 Mr. Baqar are plotting to try to have a board meeting when
4 Mr. Schwartz can't make it and that they're glad he can't make
5 it.
6 P16, that's the June 2017 minutes where Mr. Krauss
7 objects to the earlier minutes.
8 Your Honor, that brings me to the witnesses, and just
9 a couple things about each witness I'd like you to remember.
10 Mr. Krauss wasn't the only person to take notes. And while
11 everybody has tried to refresh their memory with those notes,
12 nobody else produced their notes, nobody else admitted
13 refreshing their memory by their notes. And I'd say important
14 is you heard from Mr. Krauss in detail, Mr. Hames tried to tell
15 the story maybe more than anyone else about how this was maybe
16 just a bad deal, and they were happy to get out of it, but
17 there is no real evidence of that. In fact, all the evidence
18 is to the contrary as this is what Mr. Krauss does, what he's
19 done for decades is this BNSF. And you saw early emails where
20 Mr. Swets was put on notice even by Mr. Dochter that
21 Mr. Schwartz believed in this real estate and wanted to stay
22 aboard with this. If they wanted out, they would sell it for
23 the top dollar they can get selling it, not just hold on for
24 some miniscule potential share at the end of 17 years while
25 they negotiate a lease enhancement that prevents them from

1 having any real potential upside if Kingsway were right.
2 Kingsway's version just doesn't make sense. And Mr. Krauss
3 explained alternative solutions he had in mind. And remember,
4 DGI, more so CRIC, I guess it is, was offering to buy back this
5 property. You'll see it in text messages, you'll see it in
6 correspondence from Mr. Pecci. That starts in early 2017,
7 which is before any Trump changes of the tax reform, you have
8 folks who are saying that we'll buy it back if you want. We'll
9 figure out something. They weren't running from the property.
10 They wanted the property once they knew they were in for a
11 fight with Kingsway about getting what they negotiated. Unlike
12 Kingsway witnesses, Mr. Krauss just didn't have to explain away
13 any bad emails that contradict what he said or any prior
14 inconsistent testimony the way Mr. Swets had. Mr. Schwartz,
15 what I would remind your Honor, he's a real estate guy, he was
16 excited about the property, he gets right into talking about a
17 lease enhancement with BNSF, which, by itself, could have
18 covered taxes for an even longer period of time. It would have
19 been sad, I guess, in some views of this for it to go to the
20 IRS, but it could have done it. And it would have -- the extra
21 cash flow coming in would have more than covered that.
22 THE COURT: Just to save you a little bit of breath, I
23 don't buy the argument that CRIC found themselves with a
24 property that was just going to generate headaches and they
25 didn't know what to do with it. I don't buy that argument.

1 MR. POLLACK: I had said that for sort of the last
2 time, but what gets important is the lease amendment in the
3 sense that if Kingsway's view is right, that DGI only had a
4 little to gain and CRIC only had a little to gain at the back
5 end, unless there was a big sale of the property, that the
6 property went way up in value, which has been a real potential
7 given how it's been described, they were shooting themselves in
8 the foot by doing the lease enhancement because that took away
9 the potential upside of a real transaction.
10 I'd say about Mr. Pecci, he, like every witness, says
11 the management services replaced the $20-million strike price.
12 He was involved modestly on the letter of intent. He's
13 consistent with everything. And he has no tax opinion letter
14 to defend the way Mr. Hutchens does, given McDermott Will &
15 Emery having spelled out somewhere why it is that consolidation
16 is appropriate under this deal with some description that we
17 don't know about of what management services either are or are
18 not legitimate.
19 THE COURT: Okay. You're five minutes away from where
20 you asked to stop.
21 MR. POLLACK: I think that's perfect, your Honor.
22 Mr. Willens' unrebutted opinion, that's the second tax
23 allocation agreement, in paragraph 2 of it, does not require
24 actual payments or anything owed to Kingsway. And Mr. Shaw,
25 Kingsway's expert, actually said he doesn't disagree with that,

1 he doesn't reach it, but he doesn't disagree with what's in --
2 and remember Mr. Rakhunov was going off of deposition testimony
3 there. And remember, when you think about Mr. Hutchens, how
4 his entire deposition testimony filled with I don't recall, I
5 don't recall, he tries to defend a way, as he gives stories
6 now, by saying, well, I was told if I just wasn't absolutely
7 certain, I should say I don't recall. I mean, at some point,
8 your Honor, I understand he's defending a tax opinion letter,
9 and that his firm may face some exposure here, but at some
10 point, you can't have such radical differences in your
11 positions at depositions and at trial. And I get there is some
12 description we don't know about in a tax opinion letter about
13 whether the management services are legitimate or not. My
14 guess would be they would say the management services are
15 legitimate, it would sound more like how today DGI and CRIC
16 would say, they're real value, they replaced the 20 million, or
17 they would only have to replace 18.5 because from the letter of
18 intent to the management services agreement, we start giving
19 the 1.5 back, which wasn't there, remember, in the strike
20 price. Mr. Swets, all I can say are inconsistencies and
21 evasiveness. He just wasn't there to answer your Honor.
22 THE COURT: I did not find him to be particularly
23 credible.
24 MR. POLLACK: I will leave that where it is, then.
25 I did read in from Mr. Hutchens his statement that

1 said we were just making this fee up for no reason to somehow
2 come -- oh, I'm sorry. He wanted to make it so it didn't look
3 like we were just making this fee up for no reason to somehow
4 come up with a way to shift value back to the sellers in a way
5 that the IRS, you know, thinks is not -- you know, not a good
6 document. So his testimony is, Kingsway's position is
7 supportable because we were making it look like that was real,
8 but it really wasn't.
9 THE COURT: Whose position was that?
10 MR. POLLACK: That's Mr. Hutchens, on page 143 to 44,
11 but then admits in the next question that the $20-million
12 strike price -- when asked did those services replace the
13 $20-million strike price, he did say, effectively, yes, but he
14 had just given an answer just before that, pages 143 to 44, on
15 day 2. So I think Kingsway's position entirely, your Honor,
16 turns on its ability to say something that would be contrary to
17 what would have been in the tax opinion letter and what they
18 would want to say to the IRS to support consolidation.
19 I think Mr. Hickey and Mr. Hames have covered the
20 portions of their testimony that are important. They all
21 admit, as amended from time to time, doesn't allow them to make
22 a radical change, they just think adding an express obligation
23 to pay the parent is not a radical change, but that defies
24 logic. Neither of them remembers any specific discussion.
25 Mr. Shaw just read a regulation.

1 I think I've discussed most of Kingsway's excuses, but
2 I just add that, keep in mind, they try to use Article 15 of
3 the stockholders' agreement to say, look at the evolution of
4 that and a $10-million cap, we must have been talking about
5 NOLs there, we've put the phrase contribution liability and
6 satisfaction amount in that paragraph as well. Well, your
7 Honor, $10-million cap, it's clear that if this deal were to
8 fall apart retroactively, there could be exposure for much more
9 than $10 million. If your Honor were to blow up this deal --
10 now we only have a few years. If this were decided four years
11 from now, and it's blown up, I think the exposure would have
12 been tremendous. It would go past $10 million once you reach a
13 certain date, and that's where the $10-million cap comes from.
14 And all they can point to is a hearsay email along the way
15 where Mr. Savelli says something about Leo commenting on a
16 50-percent of NOLs as a buyout, but NOLs doesn't make it into
17 the agreement. It's discussed that it's supposed to be a
18 penalty, not a gift of 50 percent of the NOLs, but a penalty,
19 so if Kingsway doesn't come through with the one thing it was
20 coming through with, because even advancing 1.5, that was going
21 back before -- once the MSA changed and the services replaced
22 the strike price, so it was 50 percent of actual out-of-pocket,
23 so it was a penalty. That's a penalty. 50 percent of NOLs
24 would not be a penalty, that would be a gift, given their
25 history.

1 And there was one point where Mr. Ruberry represented
2 to the Court during a break at the end of a day that they did a
3 deal with CVS, and they did it at full value. Well, what your
4 Honor actually heard was they didn't do the deal with CVS, even
5 though, as Mr. Dochter put it, it was being offered at 60 cents
6 on the dollar. 50 cents on the dollar for NOLs would be a
7 gift, not a penalty.
8 Your Honor, the remedies, I think I brought up. The
9 only thing I really want to stress, we lay it out in the
10 complaint, but you have enormous flexibility on how to frame
11 it, and I think your Honor can just interpret the agreement as
12 we say it should be interpreted or, if necessary, say the third
13 tax allocation agreement cannot be relied on as an equitable
14 matter because it changes the meaning of the CLSA definition
15 the way the parties didn't allow.
16 THE COURT: Let's talk about that for a second.
17 Again, because your complaint is focused on the MSA, what's
18 really at issue in your lawsuit is not the deal, it is only the
19 lease amendment, so that $25 million --
20 MR. POLLACK: Although, there are portions of that
21 that get paid on the back end, too, to DGI. So the back end to
22 DGI is a back-end 19 percent that goes to CRIC, but then there
23 are questions about the BNSF factor to be applied to the back
24 end for DGI.
25 THE COURT: Right. But there are sort of two -- well,

1 there's a question of whether there's a dollar-for-dollar
2 payment up to Kingsway, which isn't actually a payment, it's
3 more of a bookkeeping record that's going to be settled out at
4 the time of the sale. I guess your argument is that affects
5 both what they're going to get from the $25-million lease
6 amendment, as well as how the waterfall would work. Your
7 argument is that the way the waterfall works on the back end is
8 it's only actual tax payments that would get added in --
9 MR. POLLACK: Right.
10 THE COURT: -- or subtracted, however it works. Okay,
11 I got it.
12 MR. POLLACK: The way Kingsway added it, that would be
13 it.
14 Finally, I just want to refer to the award of
15 attorney's fees, your Honor, because as it's been presented to
16 your Honor in a related case, the question is whether you're
17 hearing from TRT or Kingsway, and I think your Honor knows that
18 opposing counsel here is arguing that TRT actually has an
19 obligation to Kingsway. So, on the face of it, they're arguing
20 for Kingsway, so we are actually protecting the TRT
21 constituents here by avoiding an obligation to Kingsway. And
22 if that's not clear on its face, Mr. Hess, at the end of his
23 opening statement, actually said that Kingsway -- quote,
24 "Kingsway will ask that judgment be entered in its favor," and
25 then corrected himself to say or TRT, but that's because it's

1 really Kingsway speaking there.
2 So, as I asked at the beginning, your Honor, I'll ask
3 again that the Court return judgment in DGI's favor on all
4 counts. Although, I think finding for us on Counts One and Two
5 could obviate the need to reach Count Three. I think your
6 Honor has enormous flexibility on remedy. Even if your Honor
7 does see a way to split the front-end from the back end, you
8 have the flexibility to do something with that, but we'd ask
9 for the judgment in our favor and award of attorney's fees and
10 costs in DGI's favor.
11 THE COURT: Your theory is that you're entitled to
12 attorney's fees and costs because?
13 MR. POLLACK: Well, there are one of two things your
14 Honor could do. One would be to allow us to take that first
15 out of the escrow account, because we've essentially benefited
16 TRT by fighting off a bad position taken by Kingsway in its
17 name, but that doesn't really help us if we're winning or we're
18 supposed to get 80 percent of that, because then we're only
19 getting 20 percent of our fees paid. I actually think that
20 there are certain events here, including the way this tax
21 allocation agreement was amended, certain other events that
22 would say that the positions taken here were in bad faith as
23 well, your Honor, and your Honor has, as we've laid out in the
24 proposed findings, the ability to award attorney's fees in such
25 a case, either as us representing the corporation's interests

1 and getting it out of the escrow or requiring Kingsway to pay
2 the attorney's fees here.
3 THE COURT: Thank you, Mr. Pollack.
4 We've been going for about an hour and 15 minutes.
5 Let's take a 10-minute break. It's 2:50 Eastern Time, so let's
6 break until 3 o'clock Eastern Time.
7 (Recess)
8 THE COURT: Mr. Ruberry, are your colleagues coming
9 back?
10 There is Mr. Barton. You're muted, by the way.
11 MR. RUBERRY: Good afternoon, your Honor. Mr. Hess
12 has been indisposed for a second, but he'll be right here.
13 THE COURT: Thank you.
14 Okay, Mr. Hess.
15 MR. HESS: Good afternoon, your Honor. My apologies
16 for my delay.
17 THE COURT: Quite all right.
18 MR. HESS: May it please the Court, what I intended to
19 do in my closing argument is to walk through the key events in
20 this case in chronological order.
21 THE COURT: Great.
22 MR. HESS: In March of 2015, CRIC or a CRIC-related
23 entity purchased CMC Industries through a 100 percent stock
24 sale from an entity called Macquarie. The purchase price was
25 $180 million, and CRIC financed that purchase price by

1 obtaining a loan against the rail yard that CMC Industries
2 owned in the amount of approximately $183 million. CRIC did
3 not invest any of its own existing funds, and, in fact, a
4 CRIC-related entity obtained a success fee out of the
5 difference between the $180 million purchase price and the
6 $183-million loan amount.
7 Shortly after completing that transaction, CRIC
8 started looking for a strategic partner to acquire a majority
9 interest in CMC Industries.
10 Now, the reason for that, as the parties have both
11 testified and agreed, is that CMC Industries projected to have
12 what's called phantom income in the approximate amount of
13 $112 million between 2016 and 2034, when the term of the lease
14 with BNSF was set to expire. So, the reason there was this
15 $112 million phantom income amount was essentially that BNSF
16 leased the rail yard, made a monthly payment, and the monthly
17 payment -- the monthly rent payment was designed to be exactly
18 equal to the monthly loan payment, so that there is no --
19 pardon.
20 THE COURT: I think it's the other way around, but I
21 got that, that the mortgage was structured, so that 100 percent
22 of the lease payments would pay off 100 percent of the mortgage
23 payments due.
24 MR. HESS: Right. So, the amount of the rental income
25 attributable to the interest was tax deductible. The amount of

1 the rental income that was attributable to the principal on the
2 loan was taxable. So there was this $112 million in projected
3 taxable income that CMC Industries did not have any cash flow
4 to actually pay for.
5 So, as the parties have discussed at length, this rail
6 yard that CMC Industries owned had potential high value down
7 the road. The trick of the situation for CRIC was to find a
8 way to bridge the gap between the time it purchased CMC
9 Industries from Macquarie and the time it would be able to cash
10 out if everything fell into place, and BNSF or another railroad
11 were ultimately interested in purchasing the property.
12 So CRIC was out on the market searching for an
13 acquisition partner that would be able to absorb the phantom
14 income through the time of the sale and then divvy up any
15 proceeds from the ultimate sale, which, again, was potential
16 and far down the road, but very valuable, nonetheless, if it
17 happened.
18 So, meanwhile, at the same time period in 2015, early
19 2016, Larry Swets, as the CEO of Kingsway, was searching for an
20 opportunity to use some of the approximately $850 million worth
21 of net operating loss tax credits that Kingsway had at its
22 disposal.
23 As your Honor discussed with Mr. Hames, these NOLs
24 were not assets to which Kingsway had ascribed value in its
25 statements of assets and liabilities to its investors, these

1 were line items that Kingsway had recorded, but taken a
2 100 percent valuation allowance against because whether or not
3 Kingsway ultimately would use some or all of these NOLs was
4 uncertain.
5 So what Mr. Swets was in the market looking for was a
6 symbiotic relationship with an entity that had phantom income
7 to which he could match up and use Kingsway's NOLs. So two
8 brokers named Ivan and Eric Dochter contacted Mr. Swets in or
9 about the beginning of January 2016 and asked him whether he
10 would have any interest in speaking to Mr. Schwartz, whom they
11 knew was looking to sell a majority interest on behalf of CRIC,
12 looking to sell a majority interest in CMC Industries to an
13 entity that had a significant amount of NOLs.
14 So Mr. Swets said he was interested, and Mr. Dochter
15 arranged a conversation with him, himself, Mr. Schwartz, and
16 Mr. Swets. Mr. Swets spoke to Mr. Schwartz and explained what
17 he was looking for, which was an acquisition target that would
18 allow Kingsway to receive full value for all of its NOLs that
19 it used to offset the acquisition target's phantom income and a
20 50/50 split on the proceeds of the sale of the underlying
21 asset --
22 THE COURT: Let me just interrupt you for a second.
23 You just said that Swets said to Schwartz that he was looking
24 for full value for his NOLs plus a 50 percent split. Where
25 does that come from in the record? Is that what -- did anybody

1 other than Swets testify that Swets told Schwartz he wanted
2 100 percent value for the NOLs plus a 50 percent split?
3 MR. HESS: That is from Mr. Swets' testimony. That is
4 referring to the initial conversation in early January of 2016.
5 So, as Mr. Swets testified, he explained what he was
6 looking for, 100 percent payment for the use of Kingsway's NOLs
7 and a 50/50 split on the back end after Kingsway received that
8 full compensation for the use of its NOLs.
9 According to Mr. Swets, Mr. Schwartz thought that
10 those terms were perhaps too favorable to Kingsway, and he said
11 he was going to look elsewhere, and came back and spoke to
12 Mr. Swets with Mr. Dochter approximately two weeks later and
13 said he was willing to move forward.
14 So, at that point, Mr. Schwartz and Mr. Swets
15 negotiated the letter of intent. And I'll direct Court's
16 attention to Exhibit P61. So this document, dated
17 January 30th, 2016, is a final version of the letter of intent
18 that Mr. Schwartz and Mr. Swets both signed on February 2nd,
19 2016.
20 THE COURT: Where in this does it appear that he is
21 getting full value for the NOLs?
22 MR. HESS: It does not, because as Mr. Swets
23 testified, what he did was basically back-of-the-envelope math
24 saying there's going to be $112 million worth of phantom income
25 between 2016 and 2034, and multiplying that times 34 percent,

1 results in a number just shy of $40 million.
2 So, what Mr. Swets intended to do through these terms
3 was create an economic outcome where Kingsway -- assuming a
4 sale on the back end. If there were no sale on the back end
5 for more than the $68-million balloon payment, nobody would get
6 anything. But assuming that there were a sale, these terms
7 created an outcome where Kingsway would obtain $40 million more
8 than CRIC.
9 So I'll direct the Court's attention to Defendant's
10 Demonstrative 1. So this a demonstrative showing the economics
11 of the letter of intent, as Mr. Swets testified to, and as he
12 testified he discussed with Mr. Schwartz.
13 So, under these economics, assuming sale proceeds of
14 $180 million, which apparently seemed reasonable to the parties
15 at the time, because that was essentially the purchase price
16 that CRIC had just paid, and assuming the balloon payment of
17 $68 million on the loan — that's not an assumption at all, that
18 was the balloon payment due at the time of sale under the
19 loan — there would be $112 million in free cash before the
20 50/50 split.
21 So, what the table shows below is that CRIC would pay
22 a $20-million strike price, Kingsway would receive the
23 $20-million strike price, and then separately and
24 simultaneously, there would be a 50/50 equity split of the
25 $112 million in free cash, such that the Kingsway entities

1 would obtain $76 million and the CRIC entities would obtain
2 $36 million.
3 Now, Mr. Schwartz testified that he didn't understand
4 the terms of the letter of intent and didn't understand what an
5 option was, but I find that hard to believe, considering
6 Mr. Schwartz's long career in commercial real estate and
7 especially considering that he had retained Mr. Pecci to
8 represent him to advise his entity with respect to the letter
9 of intent.
10 THE COURT: You've ignored the $1.5 million, right?
11 MR. HESS: Yes. This does not capture the
12 $1.5 million. The $1.5 million -- this is the back end, if you
13 will. The $1.5 million was just a purchase price paid from the
14 Kingsway entities to the CRIC entities at the beginning under
15 the structure.
16 THE COURT: Okay.
17 MR. HESS: So I'll direct the Court's attention to
18 Exhibit D28. This is a February 8th, 2016 email from Hassan
19 Baqar to Mr. Pecci and several other people involved in the
20 Kingsway side of the transaction plus the brokers.
21 Here, in this initial version, this is marked the
22 McDermott Will & Emery draft dated 2/8/2016, and if we scroll
23 down, the page Bates stamped TRT 4335, there is a footnote on
24 this initial draft of the stock purchase agreement saying,
25 "Seller's call option to purchase 40 percent of the company's

1 securities with a strike price of $20 million in a cashless
2 exercise upon the sale of the property or refinancing within
3 the 17-year period following the closing to be documented in a
4 separate option agreement."
5 So as of this point, as of February 8th, 2016, the
6 parties were still contemplating that the structure of the
7 transaction would include this option agreement.
8 If you would scroll up this page, please.
9 Now, Mr. Pollack has tried to make hay over the fact
10 that this initial draft includes references to both the option
11 agreement and the tax sharing agreement. I'll point out,
12 though, as Mr. Hutchens and Mr. Hames testified, this exhibit D
13 in the tax sharing agreement are in brackets, and that's simply
14 a common device used by transactional attorneys to note a
15 contractual provision that may be in the alternative or may
16 require further analysis. Mr. Hutchens testified that it was
17 never the Kingsway side's contracting intent for there to be
18 both the tax sharing agreement and an option agreement.
19 Now I will direct the Court's attention to Exhibit
20 D135. This document, 10 days later, February 18th, 2016, is an
21 email from Mr. Pecci to several representative of both the
22 Kingsway and the CRIC side saying, "Attached please find
23 responses to the tax due diligence requests that we received
24 last week along with the supporting documentation."
25 Now, if we scroll to the attachment on the page Bates

1 stamped TRT 3146, and scroll back up, question 10 asked: "Do
2 any of the CMC Industries and subsidiary companies possess any
3 tax attributes, i.e., net operating loss carryovers, tax
4 credits, et cetera, available for carryover for federal or
5 state tax purposes?" And it goes on. And Mr. Pecci wrote on
6 this page, "No federal or state NOLs or tax credits."
7 Mr. Hames, without even seeing this document during
8 his testimony, recalled that he understood, at the time he was
9 involved in drafting the definitive deal documents, that CMC
10 Industries did not have any NOLs.
11 Why that's important comes up in the drafting history,
12 but witnesses for DGI tried to argue that CMC or the CRIC
13 entities were attempting to make sure that they received
14 compensation for NOLs under the terms of the agreement. It so
15 happens that CMC Industries did, in fact, have NOLs in the 2015
16 tax period, but by the time the transaction actually closed,
17 CMC Industries had used all of those NOLs. And, in fact, it
18 seems that Mr. Pecci was under the impression as of
19 February 18th, 2016, that CMC Industries did not have NOLs.
20 Turning to Exhibit D29. This is an email on
21 March 1st, 2016, from Mr. Pecci to a number of representatives
22 of both sides of the transaction attaching a revised version of
23 the SPA.
24 If we turn to the SPA itself, the front page reflects
25 that this is Dain Torpy's March 11, 2016 comments to the

1 McDermott Will & Emery draft. If we turn to the page Bates
2 stamped TRT 1928, we see the same footnote that Mr. Hutchens
3 had drafted with a bracketed addition from Mr. Pecci saying
4 "[Per 2/23/16 call, this" — this is obviously referring to the
5 option agreement — "may be handled via a management services
6 agreement arrangement instead — under discussion]."
7 Mr. Pollack has suggested that this management
8 services agreement arrangement was Mr. Krauss' idea, but in
9 reality, what happened is that, as Mr. Hames testified,
10 Mr. Swets informed him of the structure of the LOI, the option
11 agreement, in February of 2016, and Mr. Hames said that
12 structure is not going to work from a tax consolidation
13 standpoint, which is, of course, central to this transaction
14 that it worked from a tax consolidation standpoint, and that
15 Mr. Swets proposed this alternative management services
16 agreement arrangement, and Mr. Hames, in consultation with tax
17 attorneys at McDermott Will & Emery, concluded that that
18 structure would suffice.
19 So, if we turn now to Exhibit D1, this is an email on
20 March 11th, 2016, from Mr. Swets to Mr. Schwartz, forwarding
21 the email from Mr. Hutchens to Mr. Pecci that attached the
22 draft, the initial draft, of the management services agreement.
23 So, if we scroll down here on the first page, we see this is
24 marked "MWE draft 3/11/2015," which is intended to be 16. Then
25 going to the second page --

1 THE COURT: What's the exhibit number on this?
2 MR. HESS: This, your Honor, is Exhibit D1, your
3 Honor.
4 THE COURT: Okay.
5 MR. HESS: So, turning to the second page of this
6 initial draft of the MSA that Mr. Hutchens prepared, it appears
7 a defined term contribution and liability satisfaction amount,
8 and that term is defined to mean the aggregate amount of any
9 and all (1) capital contributions made to the company or any of
10 its subsidiaries by Kingsway Financial Services Inc. (KFS) or
11 any of its affiliates on or after the date of this agreement;
12 and (2) debt, liabilities, or other obligations, including in
13 respect of taxes -- I'll note that Mr. Pollack referred to the
14 language in these drafts being inclusive of taxes, I believe
15 that Mr. Pollack meant including in respect of taxes -- of the
16 company or any of its subsidiaries, including any such debt,
17 liabilities, or other obligations owed to CVS or any of its
18 affiliates.
19 So as the people involved in drafting the definitive
20 deal documents from the Kingsway side of the transaction —
21 Mr. Hutchens, Mr. Hickey, and Mr. Hames — all testified it was
22 their understanding that it was in this definition of
23 contribution liability satisfaction amount where the MSA
24 captured the value of Kingsway's NOLs that it used to offset or
25 that it would use to offset CMC Industries' tax liability.

1 So, at this point, I'll direct the Court's attention
2 to Defendant's Demonstrative Exhibit 3, which we discussed at
3 trial with Mr. Swets and Mr. Hutchens.
4 So, like the previous version, the LOI economics
5 demonstrative, this one includes the assumption of the sale
6 proceeds of $180 million, the balloon payment, which was
7 certain, of $68 million, and this approximate NOL value through
8 2034 of $40 million. So taking that NOL value out of the
9 equation, that leaves free cash before splitting the assets or
10 splitting the proceeds of the sale at $72 million. Then you
11 see below, the way Mr. Swets and his team understood it, is
12 that the Kingsway side would first, at the time of potential
13 sale, receive compensation of approximately $40 million for the
14 NOLs that Kingsway had used to offset CMC Industries' tax
15 liability. And then, under the terms of the MSA on the sale,
16 there would be a service fee of 40 percent of free cash, which
17 would work out to $28.8 million. And then there would be an
18 81/19 equity split of the remaining $42.2 million, whereby the
19 Kingsway entities would receive $35 million, for a total of
20 $75 million, and the CRIC entities would receive $8.2 million,
21 for a total of $37 million. So, the numbers at the end, based
22 on the information that the parties were aware of at the time,
23 or at least that Kingsway was aware of at the time, work out to
24 be essentially the same. And I'll note that Mr. Pollack has
25 suggested that it was Kingsway's belief that these services

1 actually had no value. That is not Kingsway's position.
2 Kingsway, based on its understanding of how the economics of
3 the deal would work out in the event of a sale, was, in fact,
4 that DGI would receive a service fee of $28.8 million.
5 Now, there are a number of events subsequent to this,
6 that I'll get into more detail later, that would change these
7 projections. But this demonstrative here represents the SPA
8 plus MSA economics as Kingsway understood them, and as I
9 believe the CRIC entities and DGI understood them, too, at the
10 time that the parties signed the deal in May of 2016.
11 So, at that point, it appears neither party was aware
12 of the lack of inside tax basis issue, which came to the floor
13 in June of 2016. At that point, the lease amendment was a
14 glimmer in Mr. Schwartz's eye that he hadn't even disclosed to
15 Kingsway as something that was more than a possibility.
16 Moreover, the corporate tax rate had not changed and didn't
17 change until 2017. So, this is how -- what this demonstrative
18 shows here is how Kingsway believed the economics of the deal
19 would work out at the time the parties actually signed the MSA,
20 or I should say signed the SPA, which bound them to the terms
21 of the MSA.
22 So now turning to Exhibit D2, what we have here is a
23 March 22nd, 2016 email from Mr. Pecci to representatives of
24 both sides, including Mr. Hutchens, attaching revised versions
25 of the stock purchase agreement and the management services

1 agreement.

2 So if we look at the first page of the management
3 services agreement, we see this reflects that these are
4 Mr. Pecci's -- or his law firm, Dain Torpy's -- Mr. Pecci's
5 March 22nd, 2016 comments to Mr. Hutchens' draft.

6 Now I'll turn to page Bates stamped 1654 to over to
7 1655. As your Honor will see, here is where Mr. Pecci
8 introduced the term the applicable NOL deduction as defined
9 below, and then if we scroll down to the definition itself, it
10 says that "Net NOL deductions shall mean with respect to any
11 triggering event an amount equal to the NOL amount applicable
12 to such triggering event," et cetera. And then the term NOL
13 amount is defined to mean "With respect to any triggering
14 event, the aggregate amount of tax benefits derived by Kingsway
15 from the date of this agreement to the date of such triggering
16 event from any net operating losses of the company or its
17 subsidiaries."

18 Now, the company --

19 THE COURT: You lost me. What were you just reading?

20 MR. HESS: The NOL amount definition, your Honor.

21 THE COURT: Okay.

22 MR. HESS: So --

23 THE COURT: The NOL amount. Hang on a second, I'm
24 sorry.

25 All right.

1 MR. HESS: Again, this is Mr. Pecci's draft, and the
2 term the company is defined to mean CMC Industries. So, as
3 Mr. Hutchens and Mr. Hames explained, when they reviewed this
4 draft, their reaction was that this language made no sense
5 whatsoever because their understanding was that CMC Industries
6 had no NOLs, or at least would have no NOLs at the time of
7 closing, that CMC Industries could not possibly generate NOLs
8 going forward because it would have phantom income for the
9 foreseeable future, that the idea of CMC Industries somehow
10 being compensated for the use of its NOLs was the inverse of a
11 fundamental basis of the transaction, which was that Kingsway
12 would receive compensation from CMC Industries for the use of
13 its NOLs.
14 Now, Mr. Krauss and Mr. Pecci have suggested that
15 their use of this language was intentional because they wanted
16 to ensure that CMC Industries would receive compensation from
17 Kingsway for its NOLs, but that -- especially in light of the
18 February 18th, 2016 email, that does not make any sense, and I
19 would venture to say that all that happened here was that
20 Mr. Pecci intended to capture the true intent of the parties
21 and just got the identities of the parties backward.
22 Now I will direct the Court's attention to Exhibit
23 P12. This is an email from Mr. Hutchens to Mr. Pecci, copying
24 Mr. Baqar, Mr. Hames, and Mr. Orsic, Mr. Hutchens' partner at
25 McDermott Will & Emery, dated March 25th, 2016, attaching a

1 copy of the tax sharing agreement, in fact, the second amended
2 tax allocation agreement.
3 Now, Mr. Pollack has suggested that there is some
4 connection between Mr. Stilwell reengaging with Kingsway and
5 the date of April 7th, 2016, and the introduction of the
6 concept of the second amended TAA in a subsequent draft of the
7 MSA. Here it simply does not make sense that if Kingsway
8 hatched a scheme in early April of 2016 to sneak a tax
9 allocation agreement past DGI and CRIC, that it would send them
10 a copy of the agreement on March 25th, 2016.
11 Now looking at this, on this version, Mr. Hames, or
12 someone at Kingsway, had redacted the names of the entities,
13 but this version has the paragraph 2, which Mr. Willens,
14 Mr. Shaw, and Mr. Hames all testified to at length — Mr. Shaw
15 and Mr. Willens with respect to what the words actually mean
16 and Mr. Hames with respect to how he implemented the words.
17 To cut through it, Mr. Shaw offered one opinion
18 because he is a tax accountant, and Mr. Willens, as far as
19 Mr. Shaw's one opinion went, agreed with him and offered some
20 other opinions, which I'll get to later, but scrolling down to
21 Exhibit D27 here, the expert report of Mr. Shaw, Mr. Shaw's key
22 opinion in his paragraph 10 is that: "The amount of the
23 consolidated tax liability allocated under paragraph 2 of the
24 original tax allocation agreement to a consolidated return
25 member with positive taxable income and no loss carryovers

1 would generally equal its tax liability if it were filing a
2 separate return regardless to whether there was no consolidated
3 tax due for the current year and members of the consolidated
4 group with current losses or attributes would be allocated in
5 corresponding amount to reflect the absorption of their losses
6 or attributes that were utilized to reduce the consolidated tax
7 liability for the year." That's the extent of Mr. Shaw's
8 opinion. Mr. Willens does not dispute this opinion.
9 Mr. Willens just says that this allocated consolidated tax
10 liability allocated under this paragraph is not an actual
11 liability. Apparently, it's a fictitious or hypothetical
12 liability, which is a term that, as Mr. Hickey and Mr. Hames
13 testified, neither of them had ever heard of.
14 THE COURT: You don't contest that there is nothing in
15 tax law that requires a subsidiary to transfer cash equal to
16 sort of the tax benefit that they theoretically are receiving
17 compared to what would have happened if they had filed an
18 individual return. That's not required by law.
19 MR. HESS: I agree with that completely, your Honor.
20 I think this is a good point to address this issue that
21 Mr. Pollack has raised about what the scope of this lawsuit is
22 and isn't.
23 The scope of this lawsuit as a dispute between TRT and
24 DGI over the terms of the MSA is how did the parties agree that
25 the service fees would be calculated, and, more specifically,

1 did the parties agree that the CLSA included the value of the
2 NOLs Kingsway would use to offset CMC Industries' tax
3 liability, such that that value would be deducted from income
4 and cash before calculating the service fee. There's a totally
5 separate issue here of whether CMC Industries has a payment
6 obligation to Kingsway under any version of the tax allocation
7 agreement. That is simply not at issue in this lawsuit. In
8 fact, TRT is not taking a position in this lawsuit as to
9 whether CMC Industries has an obligation to pay any amount of
10 money to Kingsway under a tax allocation agreement or
11 otherwise. The parties to that dispute are simply not before
12 the Court.
13 Now, I mean, of course, it's relevant to this case
14 what understanding DGI and TRT had, but through this action,
15 TRT is not asking the Court to, in any way, compel CMC
16 Industries or its subsidiaries to make any payment to Kingsway,
17 nor is TRT making any argument about whether or not the third
18 amended tax allocation agreement is enforceable with respect to
19 CMC Industries. What TRT is arguing here is that TRT and DGI
20 reached an understanding that under the terms of the MSA, the
21 value of the NOLs that Kingsway used to offset CMC Industries'
22 tax liabilities would be deducted from the net income in cash
23 before calculating the service fee paid to DGI.
24 THE COURT: Doesn't that get to the same point? If
25 there is, in fact, no liability between CMC and Kingsway, that

1 undercuts the notion that TRT and DGI agreed that there could
2 be an offset against the cash flow for a debt that doesn't
3 exist.
4 MR. HESS: I would point your Honor to the words of
5 the MSA saying debt, liability, or other obligation, that this
6 dispute isn't about -- the word isn't payment. This dispute
7 isn't about whether CMC Industries actually has to make a
8 payment; it's about whether or not there is a liability. What
9 the parties understood the agreement to be with respect to
10 whether amounts of consolidated tax liability allocated under
11 the tax allocation agreement were liabilities. Of course, it's
12 TRT's position that DGI and TRT had an understanding that the
13 fundamental manner in which the transaction would operate would
14 be that the value of Kingsway's NOLs would be deducted in the
15 waterfall prior to calculating the service fee.
16 We can move on to Exhibit D3. This is an email from
17 Mr. Hutchens to Mr. Pecci, dated March 26th, 2016, attaching a
18 revised draft of the MSA. If we turn to the first page of the
19 attached draft, the date is March 26th, 2016, and it's an MWE
20 draft. Then if we turn to page Bates stamped -- well, first,
21 1546, you'll see that Mr. Hutchens struck the reference to the
22 NOL deduction from Mr. Pecci's draft, and then on the next
23 page, 1547, you'll see that Mr. Hutchens reverted to including
24 a definition of contribution and liability satisfaction amount.
25 And here, in relevant part, Mr. Hutchens inserted the words

1 "debt, liabilities, or other obligations, including in respect
2 of taxes — again, the words aren't inclusive of taxes — of the
3 company or any of its subsidiaries, including any such debt,
4 liabilities, or other obligations owed to CVS or any of its
5 affiliates."
6 Again, the three individuals involved in drafting the
7 definitive deal documents from the Kingsway side —
8 Mr. Hutchens, Mr. Hickey, and Mr. Hames — all testified that
9 they understood this portion of the definition of contribution
10 and liability satisfaction amount to capture the value of
11 Kingsway's NOLs.
12 Now turning to Exhibit D4. This is an email from
13 Mr. Pecci to Mr. Hutchens on April 6th, 2016 -- Mr. Hutchens,
14 as well as representatives of both sides of the transaction,
15 and this attaches revised versions of the SPA and the MSA.
16 So, first, we'll turn to the first page of the SPA.
17 You'll see this version reflects that it includes Mr. Pecci's
18 April 6th, 2016 comments. Then if we turn to Page TRT 1427,
19 this is where Mr. Pecci first introduced this concept of the
20 buyout provision in case of a default in failure to cure.
21 You'll note here Mr. Pecci wrote, in the relevant sentence, "If
22 buyer fails to reimburse seller in full within 60 days of
23 demand, then seller may or may bring in an additional equity
24 partner to purchase buyer's shares in CMC for a price equal to
25 the purchase price plus any capital contributions made by buyer

1 and the taxable value of any net operating losses utilized by
2 buyer less the reimbursement amount." I'll just ask that we
3 put a bookmark in that because we'll pick back up with the
4 evolution of that language later.
5 Now we'll turn to the management services agreement
6 draft that was attached to the same email. This is April 6th,
7 2016, again, Mr. Pecci's comments. And if we look to the page
8 Bates stamped TRT 1527, here Mr. Pecci modified the definition
9 of contribution and liability satisfaction amount, and he
10 struck the debt, liabilities, or other obligations we looked at
11 in Mr. Hutchens' last draft, and including new language that
12 included, as Romanette iii, "the value missing of any net
13 operating losses of the company or its subsidiaries utilized by
14 CVS or any of its affiliates on or after the date of this
15 agreement at the effective tax rate." Now, with respect to
16 this language, Mr. Hutchens, Mr. Hames, and Mr. Hickey all
17 testified that their immediate reaction to this language,
18 again, was that Mr. Pecci got it backwards, that CMC Industries
19 did not have, and did not project to have in the future, any of
20 its own net operating losses. The parties had agreed, from the
21 beginning, that it was Kingsway receiving compensation -- it
22 was Kingsway receiving compensation for the use of its NOLs,
23 not CMC Industries; accordingly, Mr. Hames, Mr. Hickey, and
24 Mr. Hutchens all believed that Mr. Pecci simply got it
25 backwards.

1 Now I'll direct the Court's attention to Exhibit P15,
2 which are the text messages between Mr. Schwartz and Mr. Swets.
3 If we look to the page Bates stamped 11930, we'll see on
4 April 13th, 2016, at 10:11 p.m., Mr. Swets texted Mr. Schwartz:
5 "This MSA keeps getting messed up. The tax guys are giving me
6 so much trouble." Mr. Swets testified that by "tax guys," he
7 was referring to Mr. Hames and Mr. Hickey. "Can we get Tim" --
8 Tim Pecci -- "to fly out, and you if you want, and sit with our
9 lawyers, so we can make them sit in a room until both agree."
10 Mr. Schwartz responded: "Let them try it on the phone
11 and scrib it out on the phone. Your attorneys heard and then
12 did not write it."
13 Mr. Swets responded: "They say 'distribution' as a
14 word won't work. They say the old language covered the
15 scenario. Both of us agree — needs to get covered if the
16 property cash flows. Tim's language won't work, and my guys
17 say old language did. It is so frustrating ... let's do a call
18 then. I will schedule it. Sorry this is so difficult, but you
19 and I both want the tax opinion for consolidation."
20 Now this dispute over the word distribution is not
21 squarely at issue in this lawsuit, but as Mr. Swets testified,
22 another major concern that Mr. Hickey and Mr. Hames brought to
23 him was that Mr. Pecci appeared to get his language backwards
24 in trying to capture the value of Kingsway's NOLs in the MSA.
25 Now we'll turn to Exhibit D6, and this is the email

1 from Mr. Hutchens to Mr. Pecci and several representatives of
2 both sides on April 15th, 2016, sent at 10:29 a.m., which was,
3 as Mr. Pollack noted, one minute before the scheduled meeting,
4 to discuss the concerns that Mr. Swets had raised with
5 Mr. Schwartz on the 13th. Here, there is no question of
6 Mr. Hutchens trying to hide the ball or anything by sending
7 this right before the meeting. He was just -- well, in fact,
8 the documents from the privilege log reflect that Mr. Hutchens
9 had been working feverishly with Mr. Hames and Mr. Hickey in
10 drafting this revised version of the MSA, and there is
11 absolutely nothing unusual about the people tasked with
12 drafting the definitive deal documents at the client company
13 having extensive email communications with their outside
14 counsel in the 48 hours leading up to the disclosure of a
15 revised draft.
16 But, anyway, if we turn to this page of the MSA that's
17 Bates stamped 1259 and on to the next page, here's where
18 Mr. Hutchens drafted the contribution and liability
19 satisfaction amount definition to include, in relevant part,
20 (iii), "debt, liabilities, or other obligations of the company
21 or any of its affiliates, including any such debt, liabilities,
22 or other obligations owed to KFS or any of its affiliates,
23 whether pursuant to the tax allocation agreement or otherwise."
24 As Mr. Pollack noted, the evidence shows that there
25 was no scheme to amend the tax allocation agreement in the

1 future under the definition of tax allocation agreement, but
2 this referred to the second amended TAA.
3 So, Mr. Pollack showed the Court Exhibit P16, the
4 notes that Mr. Krauss kept of the call that immediately
5 followed Mr. Hutchens' disclosure of this document.
6 Mr. Pollack suggested that I would make some argument based on
7 the fact that Mr. Krauss wrote taxable value of net operating
8 losses needs to be defined, although I would note that
9 Mr. Krauss testified that he generally wrote down things other
10 people said. TRT is not relying on this note. TRT is relying
11 on Mr. Hutchens' testimony about what he said during this phone
12 call. Mr. Hutchens testified what he explained to Mr. Swets,
13 Mr. Savelli, Mr. Pecci, Mr. Schwartz, and Mr. Krauss during
14 this call was that what he had intended to do in inserting the
15 direct reference to the tax allocation agreement was to define
16 the mechanism whereby the parties would calculate the value of
17 the NOLs that Kingsway used to offset CMC Industries' taxable
18 income before calculating the service fees.
19 Mr. Pollack also directed the Court's attention to the
20 second page of these notes. And here, toward the bottom, as
21 Mr. Pollack noted, Mr. Krauss wrote, "MSA — 50 percent other
22 than taxes, contributions, et cetera," and Mr. Krauss testified
23 that these were Mr. Swets' words. Even assuming that this is
24 verbatim what Mr. Swets said during this call, as Mr. Swets
25 testified when he was referring to taxes with respect to this

1 deal in his communications with Mr. Krauss and Mr. Schwartz, he
2 was referring to the dry taxes of CMC Industries, that Kingsway
3 would offset that through the use of its NOLs, and that
4 Mr. Swets understood, from the time of his first conversations
5 with Mr. Schwartz in January, that this was a fundamental
6 precept to the transaction that Kingsway would be receiving,
7 when there was cash flow, which was not projected to be until
8 the end, would be receiving full compensation for the value of
9 its NOLs before the 50/50 split.
10 Mr. Krauss has suggested that, at some point in time,
11 when the parties were making the transition from the option
12 agreement under the LOI to the MSA structure under the SPA,
13 that Mr. Krauss made clear that his intent was to be changing
14 the fundamental economics of the transaction. Mr. Krauss
15 claims he said that, but that is not reflected in his notes
16 directly and is not reflected in any other documentary evidence
17 that's been presented to the Court in this case or has even
18 been produced in this case, and it's simply Mr. Krauss' word.
19 And Mr. Hutchens, Mr. Swets, Mr. Hickey, who was not on all the
20 calls, and Mr. Hames have all testified -- who also was not on
21 all the calls, to be fair -- all testified that they never
22 heard Mr. Krauss say any such thing and that they never heard
23 Mr. Krauss say that Kingsway would not receive any compensation
24 for the value of its NOLs other than a 50/50 split on the back
25 end.

1 THE COURT: Do you agree, though, that there is no
2 evidence that any of those people ever said, in words or
3 substance, to any of the people from the CRIC side, you're
4 going to be paying -- on the back end, we will collect
5 dollar-for-dollar for the use of NOLs, that that was never
6 said? Whatever they may have thought, that was never said or
7 they never exchanged proformas to show how the dollars would
8 get divided up?
9 MR. HESS: Mr. Swets testified that he explained that
10 to Mr. Schwartz on the very first phone call at the beginning
11 of January in 2016. Mr. Hutchens, as I just mentioned,
12 testified with respect to the MSA that what it contemplated or
13 what his latest draft as of April 15th, 2016, contemplated was
14 that the tax allocation agreement would be the mechanism
15 whereby CMC Industries would compensate Kingsway through the
16 use of its NOLs and that that value would be deducted in the
17 waterfall.
18 THE COURT: Right. But then you're dealing with the
19 ambiguity whether he meant actual dollars of tax payments
20 versus use of an NOL including tax payment, right?
21 (Unintelligible) itself, the second tax allocation agreement
22 did not say expressly that there was a required payment of cash
23 for the value of the NOL that was used by the subsidiary,
24 correct? I'm just trying to figure out what the --
25 MR. HESS: There is no dispute. The second amended

1 tax allocation agreement includes no express payment provision.
2 There is no dispute about that, and, also, I don't think there
3 is any --
4 THE COURT: Excuse me.
5 MR. HESS: Pardon me, your Honor?
6 THE COURT: Excuse me. I was trying to get you to
7 stop talking, so that I could ask my question.
8 Other than Swets' testimony of what he said to
9 Schwartz in their first meeting, none of all of these people in
10 any of their meetings ever said to the people on the CRIC
11 side — Pecci, Schwartz, or Krauss -- I think that's it, maybe
12 there's somebody else in there -- the dollar-for-dollar payment
13 of the NOLs is going to be required before you ever get any
14 money on the back end, in words or substance; is that correct?
15 MR. HESS: No, your Honor. Mr. Hutchens testified
16 that he made such a statement in words or substance during the
17 April 15th, 2016 phone call.
18 THE COURT: Do you have a page cite for that?
19 MR. RUBERRY: Yes, we do, your Honor.
20 MR. HESS: Just a moment, your Honor. I believe it
21 appears in pages 275 through 285 of the rough draft of the
22 transcript, your Honor.
23 THE COURT: Okay. It gets us a little closer.
24 Again, what you had just said a little while ago, and
25 that's why I was pressing you, was that he testified that he

1 told them that he intended for the TAA to define the mechanism
2 through which the parties will calculate the value of the NOLs,
3 that is what was going to be paid for the NOLs, which is a
4 little different from saying, in words or substance, you're
5 going to be paying dollar-for-dollar for the NOLs to wipe out
6 your phantom income, do you understand that, correct?
7 MR. HESS: I agree, your Honor.
8 THE COURT: But is that the testimony you're relying
9 on, that his -- that he told them that he intended the
10 reference to the tax allocation agreement to be the mechanism
11 to define the value of the NOLs?
12 MR. HESS: Right, your Honor. That is the piece of
13 information I am pointing to as most relevant, because, as I
14 said earlier, I mean, obviously, this issue of payment for NOLs
15 is entangled in this lawsuit, but the key issue in this lawsuit
16 is whether the parties understood that the value of the NOLs
17 would be deducted through the waterfall provisions of the MSA.
18 THE COURT: You're separating two things that I don't
19 understand how, as a practical matter, they actually get
20 separated.
21 MR. HESS: I mean, in a -- hypothetically, your Honor,
22 there could be, I suppose, a situation in which two parties
23 agreed on how some payment would be calculated under a contract
24 without agreeing as to how the parties to some referenced
25 contract would negotiate their rights and duties to each other.

1 I agree it would be cleaner if all the entities were involved
2 in one case, but the way it worked out is we have a lawsuit
3 here between DGI and TRT, so I would hazard to say it wouldn't
4 be appropriate for me to take any position as to what other
5 entities' rights and obligations are under other contracts. To
6 be clear, though, TRT's position is that TRT, and DGI, and the
7 related entities understood, A, that the value of the NOLs
8 would be deducted through the waterfall; and, B, that CMC
9 Industries would eventually compensate Kingsway for the use of
10 its NOLs.
11 So if we could turn to Exhibit D8. This is an email,
12 dated April 19th, 2016, from Mr. Hutchens to Mr. Pecci and
13 representatives of both sides of the transaction, attaching a
14 draft stockholders' agreement. If we look at the first page of
15 the attachment, it's an MWE draft dated April 19th, 2016. If
16 we turn to page 15, paragraph 15A, this is where the footnote
17 from an earlier draft of the SPA was actually captured in the
18 stockholders' agreement, and here, for this buyout provision,
19 in the event of default and failure to cure, it says, "If
20 CMCA" — that's CMC Acquisition wholly owned by Kingsway —
21 "fails to so reimburse CRIC within such 60-day time period,
22 then CRIC may elect to purchase all (but not less than all) of
23 the shares held by CMCA for a price equal to X, $1.5 million,
24 plus Y, the contribution and liability satisfaction amount, as
25 defined in the management services agreement as of the closing

1 date of such purchase minus the loaned amount." What this
2 shows is that the words taxable value of any net operating
3 losses by Kingsway from Mr. Pecci's draft evolved to the CLSA
4 as defined in the MSA.
5 So let's continue on to Exhibit D9. This is an email
6 on April 27th, 2016, from Mr. Krauss to Mr. Swets. If we go to
7 the second page, Mr. Savelli, the senior vice president of
8 finance at Terracap, wrote in his email, "Leo to comment on
9 Larry's suggestion of the 50 percent buyout of NOLs on
10 default." Larry Krauss testified that he is the Larry who made
11 this suggestion. And then if we turn to the attachment, Larry
12 Krauss testified that he is the person who implemented this
13 suggestion by inserting 50 percent of before the reference to
14 the CLSA as defined in the MSA. So this is clear evidence that
15 Mr. Krauss understood that the value of NOLs was part of the
16 contribution and liability satisfaction amount. If you scroll
17 back up to the email, Mr. Krauss testified that what 50 percent
18 buyout of NOLs on default actually meant was 50 percent buyout
19 in the case of an NOL default.
20 Now I would just direct the Court to the plain words
21 on the page, which says "buyout of NOLs on default," and
22 granted, these are Mr. Savelli's words, but if he meant to
23 refer to something called an NOL default, which, by the way, is
24 a foreign term to everyone who testified, other than Mr. Krauss
25 at the trial, Mr. Savelli would have just said NOL default.

1 The only point for which we are introducing this
2 document is that this shows that Mr. Krauss actually understood
3 that contribution and liability satisfaction amount, as defined
4 in the management services agreement, included the NOLs.
5 Now turning to Exhibit P34.
6 THE COURT: Hang on just a second.
7 Okay. P34?
8 MR. HESS: Yes, your Honor.
9 This is an email on April 29th, 2016, from Mr. Swets
10 to Mr. Schwartz, asking how about 50 percent with a cap of
11 $10 million on the cure repurchase. As Mr. Swets testified,
12 this is an email he sent to Mr. Schwartz during a group
13 conference call in which they were discussing this provision
14 15A of the stockholder agreement. Also, as Mr. Swets
15 testified, and as a matter of logic, this 50 percent with a cap
16 of $10 million on the cure repurchase would come into play only
17 if the contribution and liability satisfaction amount somehow
18 exceeded $20 million, and there is simply no conceivable way
19 that if the CLSA does not include the value of the NOLs that
20 Kingsway used to offset CMC Industries' tax liabilities, that
21 could ever approach anywhere close to $20 million.
22 So I'll turn the Court to Exhibit D11. This is an
23 email from Mr. Pecci to Mr. Hutchens and representatives of
24 both sides of the transaction on May 6th, 2016, attaching
25 comments -- revised drafts of the stockholders' agreement and

1 management services agreement. And if we look at the first
2 page of the draft management services agreement, it shows that
3 this is Mr. Pecci's draft dated 5/5/2016. If we then turn to
4 page Bates stamped 896, that's TRT 896, you'll see that this is
5 the draft where Mr. Pecci inserted language referring to the
6 BNSF transaction and the BNSF factor. So, again, this is
7 May 6th, 2016, just 11 days prior to the execution of the SPA,
8 and this is when Mr. Pecci inserted this notion of some
9 different set of calculations coming into play if Mr. Schwartz
10 were to negotiate a lease amendment with BNSF.
11 Now, Mr. Schwartz, apparently, was busy negotiating
12 this since at least March of 2016, and it certainly seems that
13 it was in the front of his mind, but the Kingsway witnesses,
14 two of them, have testified that what they were focused on
15 was -- and the only outcome they believed was reasonably
16 possible was an eventual sale of the rail yard when the party
17 would divvy up the proceeds. Kingsway was not focused, and TRT
18 either, which would be represented by Larry Swets, neither
19 Kingsway, nor TRT considered in any depth what the outcome
20 would be if there were changes to the lease.
21 So turning now to Exhibit P5. This is the executed
22 copy of the stock purchase agreement, dated May 17th, 2016. I
23 would just note that if we scroll down here — and these are
24 just excerpts, so we skipped a whole lot of pages there — but
25 I'm just pointing out to the Court that the final form of the

1 terms of the management services agreement, as well as
2 stockholders' agreement, were appended to this version of the
3 SPA. In terms of what the parties understood and intended at
4 the time of the transaction, the time that matters is May 17th,
5 2016.
6 I'll take you to Exhibit D109.
7 THE COURT: Mr. Hess, my internet connection went out
8 just right at the end of your last sentence. What matters is
9 what their intent was at the time they executed the agreement,
10 maybe is what you said?
11 MR. HESS: Right, on May 17th, 2016.
12 THE COURT: Okay.
13 MR. HESS: Going on to D109.
14 Before I get to here, in our chronology, after the
15 parties signed the SPA and committed to the terms of the
16 ancillary agreements on May 17th, 2016, Mr. Hames and
17 Mr. Hickey were involved in tax due diligence, and, as I
18 mentioned earlier, it came to their attention in June of 2016
19 that they believed CMC Industries had no or close to no inside
20 tax basis in the rail yard. And they had a discussion --
21 THE COURT: Mr. Hess, did you ask me for a warning?
22 Because if so, you're about 15 minutes from the end.
23 MR. HESS: Fifteen minutes, your Honor?
24 THE COURT: Yeah. I may be giving you a little extra
25 time.

1 MR. HESS: Thank you.
2 They discovered this in June of 2016 after the
3 effective date of the SPA -- after the parties signed the SPA,
4 and apparently Mr. Bates, who is the tax attorney for the CRIC
5 entities, came to that conclusion at the same time. So, again,
6 in terms of what was relevant to the parties' intent at the
7 time they entered into this transaction, the apparent lack of
8 an inside tax basis was not.
9 So, here we have, this is Exhibit D109 --
10 THE COURT: Just a second. Nevermind, go ahead.
11 Okay.
12 MR. HESS: Your Honor, so this is Exhibit D109, dated
13 July 13th, 2016.
14 THE COURT: B or D? D.
15 MR. HESS: D, yes.
16 This is the document attaching CRIC's statement of
17 assets and liabilities prepared in connection with the closing,
18 and, again, if we look at the statements of assets and
19 liabilities, CRIC's own statement of CMC Industries' assets and
20 liabilities reflected that its liabilities were approximately
21 $11 million greater than its total assets.
22 Now, as your Honor noted, it's true that the numbers
23 here reflect an inherent value of $21,120,000 in the rail yard,
24 and that's a matter of GAAP accounting. Of course, there is a
25 separate issue of the potential value of the rail yard down the

1 line, but in terms of -- the representation that CMC Industries
2 was a highly valuable entity as of March 31st, 2016, CRIC's own
3 statement of assets and liabilities belies that, especially
4 given that the rail yard was encumbered by a loan, which is
5 referred to in shorthand as a Wells Fargo loan, in the amount
6 of over $180 million.

7 THE COURT: I don't understand this argument. The one
8 thing I think both sides agree is that there was a perception
9 that there was value here. It was value way down the road, but
10 there was going to be a payout.

11 MR. HESS: Absolutely. I mean, it wasn't a sure
12 thing, but there was a potential big payout at the end in 2034.
13 What CRIC needed was a bridge to that point because --

14 THE COURT: They needed a solution.

15 MR. HESS: They needed a solution.

16 THE COURT: There is no question about that, but I
17 don't understand the point of this. To argue that they were
18 getting no value or that this was -- the company they were
19 buying had no value just is belied by what we've just spent
20 weeks trying, and the fact that both parties clearly understood
21 that, yes, land can lose value, but I think the smart money was
22 on this rail yard was not going to fall into disarray or
23 disuse, so that all of a sudden, what was a multimillion dollar
24 rail yard was all of a sudden going to become worth a mere
25 $21 million. So my point is, I don't see where you're going.

1 MR. HESS: What this document shows I don't know is
2 even in dispute. It's basically the only value here is -- the
3 only net value here is this potential sale down the road.
4 THE COURT: As of this point before they negotiated
5 the option deal?
6 MR. HESS: Right.
7 THE COURT: So we're not going to belabor that.
8 MR. HESS: Right. So, essentially, on this point,
9 before I move on, essentially, what Kingsway was able to do
10 here for CRIC was to offer an interest-free loan to the time of
11 closing, because if not for Kingsway or another similarly
12 situated partner, which it appears there were very few --
13 THE COURT: There is no evidence of that, to be clear.
14 I know that Swets said he was the only guy in town, he had CRIC
15 over a barrel. What I heard from Mr. Krauss, who was an
16 extremely credible witness, is that he knew what he was doing,
17 he knew what he was buying, there were other ways this deal
18 could be structured, so that he could take care of the phantom
19 income, and he was also prepared to pay the taxes, so that he
20 had several -- for at least some period of time, he was
21 prepared to pay the taxes, so that it was not like he was in a
22 fire sale circumstance.
23 MR. HESS: Even if Mr. Krauss had been able to access
24 the capital to pay the taxes, he still would have had to owe
25 them in realtime. What Kingsway was offering here was to

1 absorb the tax liability all the way up until the sale, it's
2 basically an interest-free loan, and then get the compensation
3 for its NOLs on the back end. Of course, everything changed
4 when the lease amendment went through, but that was months
5 after the transaction itself.
6 THE COURT: Let me say, also, it was an interest-free
7 loan and did not cost the lender a penny. It picked up the
8 loan as being I take money out of my pocket and lend it to you.
9 That leaves me with less capital. In this case, it wasn't
10 costing Kingsway a penny.
11 MR. HESS: Right. So --
12 THE COURT: So, yes, again, I don't want to drag you
13 off into this because I don't think that's the point.
14 Everybody agrees that both sides benefited from a deal.
15 MR. HESS: Absolutely.
16 THE COURT: And as we discussed at the very beginning,
17 the plaintiffs are not asking that the SPA, and the MSA, and
18 all those agreements be blown up.
19 MR. HESS: Right. Although it did seem that
20 Mr. Pollack left that possibility open. But, yes, your Honor.
21 THE COURT: Okay. Okay, good. So let's get to --
22 you're probably out of time, but you haven't gotten to the
23 critical stuff, so I'm going to let you keep going, so that you
24 can explain to me why I should not find how the third tax
25 allocation agreement came to be born is a really bad set of

1 facts for your client.

2 MR. HESS: Certainly, your Honor.

3 So what we have here is DGI's redline prepared for
4 this litigation comparing the second and third tax allocation
5 agreements.

6 When Mr. Hames testified, he explained that he, on his
7 own initiative, made these changes in mid-November of 2016
8 because of the fact that he needed to have this agreement
9 finalized for tax purposes by the end of 2016 and he needed to
10 obtain regulatory approval first. As Mr. Pollack has noted,
11 Mr. Hames inserted many new passages, including this new
12 paragraph 5. As Mr. Hames explained, every year, regardless of
13 whether the third amended or the second amended tax allocation
14 agreement had been in place, he worked with the outside CPA,
15 Mr. Simkin, to calculate the amount of tax liability to be
16 allocated and tax benefit to be allocated to each party and
17 then prepared a summary spreadsheet, discussed it with
18 Mr. Hickey, and then instructed people in the accounting
19 department to effectuate the transfers of funds among the
20 entities. So, as Mr. Hames testified, from his perspective,
21 his changes he made were clarifying edits that did not have any
22 material impact on the way in which he calculated the tax
23 liabilities and tax benefits allocated to the various
24 subsidiaries.

25 As Mr. Hames testified, in late 2016, he discussed the

1 nature of the changes he had made twice with other people at
2 Kingsway, once in November with Mr. Hickey before the insurance
3 company subsidiaries made their Form D filings and once with
4 Mr. Baqar in December, shortly before the board meeting that
5 occurred on December 16th, and Mr. Hames testified that in both
6 instances, he explained that the changes he had made were
7 clarifying edits.
8 THE COURT: Why wasn't this sent to the other board
9 members in a timely way? It was done at least a month before
10 the board meeting. That strikes me as an effort to hide the
11 bone.
12 MR. HESS: Well, your Honor, I could speak to what
13 Mr. Hames testified to, which is that the -- when he was
14 working on this in November, what he was focused on was making
15 these changes, so he could submit it for a regulatory approval,
16 and in December, it came to his attention that there was going
17 to be this board meeting, so he -- so Mr. Hames shared it with
18 Mr. Baqar. It is true that no representative of the Kingsway
19 entities sent the email to -- sent the third amended tax
20 allocation agreement to any representative of the CRIC entities
21 until after the meeting. Beyond that, I believe Mr. Baqar
22 testified on deposition that's designated that it was an
23 oversight to not send it, but I'm not 100 percent sure of that
24 because it's been a long time.
25 THE COURT: I don't remember either, but I think as I

1 said before at the final pretrial conference, Mr. Baqar is not
2 particularly credible in his deposition, and having sat through
3 this trial and seeing the amount of traffic that went through
4 Baqar, he really is less credible. This is a small -- as was
5 everyone in your client's sort of insistence that no one ever
6 talked to anybody about anything, but there was never the sort
7 of conversation that I would have expected in a shop this small
8 to have been had about a deal this big, that there would have
9 been a discussion, whether Swets was on the phone or in
10 presence about exactly what the deal was, exactly was what the
11 understanding is, all that stuff. But Mr. Baqar says it was
12 just an oversight, but he also said I didn't have anything to
13 do with this deal. He signed these agreements before there was
14 ever a corporate approval for them. Okay.
15 MR. HESS: May I just sum up quickly and pass the
16 baton?
17 THE COURT: Please do.
18 MR. HESS: So, your Honor, what we have here is a deal
19 that made sense to both parties as they negotiated it based on
20 the facts that existed at that time. The facts being -- and
21 that time being the period from January through May of 2016.
22 The facts being that CRIC owned CMC Industries, whose sole
23 asset was the rail yard in Dayton, Texas. That rail yard was
24 encumbered by a loan in the amount of approximately
25 $180 million at that point, BNSF was the tenant on a lease that

1 ran through 2034, the amount of the monthly rent payment was
2 exactly equal to the amount of the monthly loan payment, and so
3 CMC Industries had no positive cash flow, but had $112 million
4 in projected phantom income through 2034. Neither side, until
5 after May, seems to have been aware of the lack of an inside
6 tax basis. And when I say "seems," Kingsway was not, and it
7 seems that CRIC was not either, but that's not entirely clear.
8 And the lease amendment was not yet in place, and the tax rate
9 was 34 percent.
10 So what CRIC brought to the table was an opportunity
11 to cash in down the road and probably in 2034 on a sale. What
12 Kingsway brought to the table was a way of protecting CRIC from
13 having to pay almost $40 million in taxes through 2034. And
14 the parties reached an agreement. It seems that Mr. Swets and
15 Mr. Schwartz reached an agreement. Their initial intent was
16 for Kingsway to obtain $40 million more on the back end than
17 CRIC, and the MSA was simply an elegant solution to create the
18 same economic outcome while maintaining eligibility for tax
19 consolidation. There is no evidence, aside from Mr. Krauss and
20 Mr. Schwartz's unsubstantiated testimony, that the fundamental
21 economics of the deal ever changed.
22 THE COURT: But suppose I find their testimony
23 credible.
24 MR. HESS: Okay. I think, in that case, the same goes
25 for what Mr. Pollack said. If you find everyone to be credible

1 or mostly credible and perhaps a little mistaken, then there
2 wasn't a meeting of the minds.
3 THE COURT: Then what?
4 MR. HESS: If there wasn't a meeting of the minds --
5 and we can present this in our posttrial submissions, but if
6 there wasn't a meeting of the minds on this key term of the
7 transaction, the key term being how the service fee would be
8 calculated, then neither party could obtain specific
9 performance from the other based on its unilateral
10 understanding of that key contract term.
11 THE COURT: So, Mr. Hess, under your theory, under
12 your side's position on all of this, why would Mr. Krauss have
13 lifted a finger to negotiate the BNSF -- the subsequent deal
14 with BNSF?
15 MR. HESS: Your Honor, I assume you mean Mr. Schwartz
16 for the record, but --
17 THE COURT: Probably.
18 MR. HESS: I mean, frankly, it seems to me, your
19 Honor, that Mr. Schwartz had a misunderstanding of how the
20 contract would work in the event of this lease amendment. It
21 seems that Mr. Schwartz's understanding was that if he were to
22 negotiate a lease amendment, he would be able to obtain
23 80 percent of the net benefit. I would just be speculating,
24 but perhaps the language Mr. Pecci inserted into the agreement
25 was inconsistent with what Mr. Schwartz intended for him to

1 insert into the agreement, but the fact of the matter is --
2 well, to a certain extent, it's a separate issue because all
3 we're talking --
4 THE COURT: That's the issue in the lawsuit, right?
5 The lawsuit is focused on what DGI is entitled to in terms of a
6 service fee, all of which -- the only reason there is cash
7 available is because of the lease amendment.
8 MR. HESS: Right. As Mr. Pollack noted, had it not
9 been for the lease amendment, this fight might be happening in
10 2034, and the parties might have gone on with their business
11 without even coming to it.
12 THE COURT: I think that's right.
13 MR. HESS: But, from Kingsway perspective, it was
14 focused, up to the time of the transaction itself, on this
15 outcome in which there is a sale at the end and no positive net
16 cash flow. I mean, Mr. Schwartz attempted to create this kind
17 of exceptional circumstances provided for in the contract as to
18 what would happen if there were a lease amendment, and I
19 believe that -- I showed you where Mr. Pecci inserted the
20 language, I don't believe there was really any back-and-forth
21 about that specific language.
22 THE COURT: You showed it to me, and then you spent
23 absolutely no time talking about it. The only reason you
24 mentioned it was to argue that that was the first indication
25 that the parties had any conception that there might be a lease

1 amendment, that that was the first mention in any of the
2 documents is when Pecci introduces that into the agreement, and
3 then that's all you ever said about it.
4 MR. HESS: Well, that's -- sorry. That's all I
5 intended to say about it. I was simply making the point that
6 it was Mr. Pecci who injected this issue at the end and that
7 there was not a huge amount of back-and-forth about it.
8 THE COURT: Right. But, Mr. Hess, I guess that's my
9 point. So we agree that's the point in time, and what the
10 parties are all thinking and intending is critical to figuring
11 out whether you had a meeting of the minds on all of this. The
12 one thing relative to the fact at hand that I know is that
13 before the deal was executed, there was introduction into the
14 scenario of this possibility of added cash flow, and we further
15 know that Mr. Schwartz made it his business to negotiate the
16 deal and get the added cash flow. I'm trying to square that
17 with the notion that he gets no benefit because that added cash
18 flow gets gobbled up in what Kingsway and TRT argues is money
19 that's due to Kingsway because of the use of NOLs. So Schwartz
20 was essentially doing nothing on his own behalf.
21 MR. HESS: Your Honor, do bear in mind that at that
22 time, though, Mr. Schwartz was negotiating, apparently, the
23 lease amendment, the exact -- he didn't know the exact terms.
24 There's some point between 25 and $40 millions in terms of
25 enhanced lease payments where there would be quarterly service

1 payments.
2 THE COURT: How? Aren't they always going to get
3 gobbled? They're not going to be big enough to overcome the
4 tax savings from the NOLs, are they? And if they are, they're
5 only going to be in the very first couple of years.
6 MR. HESS: Right. This is why I say I don't -- I
7 believe Mr. Schwartz's understanding was that if he were to
8 negotiate this lease amendment, he would be able to collect
9 money on an ongoing basis.
10 THE COURT: Which only makes sense if he did not think
11 that at the very top of the waterfall was a dollar-for-dollar
12 repayment of Kingsway's NOLs.
13 MR. HESS: Well, this is pure speculation, your Honor,
14 but I think another alternative explanation could be that
15 Mr. Schwartz didn't intend for this BNSF transaction proceeds
16 to go through the waterfall at all or to go through exactly the
17 same elements of the waterfall. I mean, this is pure
18 speculation, but --
19 THE COURT: Okay. Understood. It's 4:50. Are you
20 done, Mr. Hess? I thought you were finished, and then I asked
21 you a question, so I didn't mean to cut you off.
22 MR. HESS: You did not, your Honor. Thank you. I am
23 done.
24 THE COURT: It's 4:50 Eastern Time. Let's take a
25 10-minute break, and then we'll hear Mr. Pollack's closing

1 remarks.
2 (Recess)
3 THE COURT: Okay, Mr. Pollack.
4 MR. POLLACK: Thank you, your Honor.
5 Your Honor just addressed Mr. Hess with some questions
6 about the BNSF transaction being introduced, and actually,
7 there's an aspect of that. One is whether it would get
8 approved, the second is whether it would be monetized. And as
9 these sort of discussions ensued, recall that's where P36 comes
10 in, which Mr. Rakhunov is putting up. This is where Mr. Swets'
11 response is, "It should definitely work with the sale. I don't
12 know how to deal with refinancing. I'm open to ideas, but
13 can't figure out how to solve it other than trust us." What I
14 want to do is link that in, that Mr. Hess' efforts -- it's one
15 thing to frolic through drafts, and there can be times -- a
16 detour to them, I should say --
17 THE COURT: Mr. Pollack, sorry to interrupt. This was
18 P what, that you have on the screen?
19 MR. POLLACK: P36 on May 2nd --
20 THE COURT: Somebody has an echo.
21 Why do you think that is about the lease amendment?
22 MR. POLLACK: Well, we're into May 2016 as the
23 discussions are happening between Mr. Schwartz and Mr. Swets,
24 and he's saying what about the refinancing. And a refinancing
25 was being considered within the context of when there would be

1 greater rents coming in. That's the refinancing that would
2 happen, so that Mr. Swets is trying to say, you know, just
3 trust us. That's where I think the detour through drafts can
4 be important, but not a frolic.
5 I want to put up P7, because a big portion of
6 Mr. Hess' argument, twice, tried to distinguish between this
7 case where your Honor should look at the waterfall, but not
8 consider whether there is an actual payment obligation because
9 now we've had Mr. Hames and Mr. Hess acknowledge that the
10 second tax allocation agreement did not have an express payment
11 obligation by the sub to parent. We've had Mr. Willens say
12 paragraph 2 doesn't do it. Mr. Shaw doesn't say paragraph 2
13 does it. In fact, he said he doesn't disagree with
14 Mr. Willens. Nobody has suggested the second tax allocation
15 agreement actually has language with a payment obligation with
16 a sub to the parent, because at some point, you just can't say
17 something that's not there. And if you look at the definition,
18 it's not just debts, liabilities, or obligations under the tax
19 allocation agreement, which if it were phrased that way might
20 be more ambiguous. Here it's completely clear, owed to KFS or
21 any of its affiliates under that tax allocation agreement. So
22 it's not just there has to be some conceptual liability in
23 terms of an apportionment, but it has to be something, as the
24 final language says, owed to KFS or any of its affiliates.
25 Again, the third tax allocation agreement shows how

1 language could be in place to require it to be owed, and that's
2 why they went in that direction, your Honor. If you take the
3 kernels of truth within Mr. Hames' testimony -- because I think
4 Mr. Hickey tried to be a credible witness. He admitted he
5 wasn't on any conversation. All he had to do was give his edge
6 toward how he interpreted things along the way. Mr. Hames was
7 a bit more resistent to even admit that the vice president of
8 tax is trying to minimize tax exposure, but even he admitted
9 there was no express payment obligation, and then he says his
10 initiative -- I don't think he said it was his initiative to do
11 it; I think his words were nobody instructed him to create the
12 third.
13 And your Honor saw that October 24th, 2016 email, in
14 which Mr. Swets starts to say, I don't want to approve things
15 that get them a greater share of the back end. That's when you
16 see this team of four — Mr. Swets Mr. Baqar, Mr. Hickey, and
17 Mr. Hames — plotting, running projections. And within 24 days,
18 there is not only a third tax allocation agreement drafted, but
19 it's sent off to a regulatory body for approval. It gets
20 signed before Mr. Baqar, not only before it's approved, but
21 before Mr. Baqar is even an officer of CMC. So this gets back
22 to our whole theme about the way Kingsway keeps distancing
23 itself, and it's distancing itself from the third tax
24 allocation agreement for the very reason your Honor asked the
25 question. Isn't that a bad fact, bad set of facts, bad set of

1 circumstances. It's awful for them. They put in writing the
2 very thing they would need to make their case a little
3 stronger.
4 Now let's look at -- your Honor's question was, did
5 anybody say that you'd have to pay dollar-for-dollar for the
6 tax savings and benefits from the NOLs, and they said to your
7 Honor, making it sort of tough to look at on the fly, between
8 pages 275 and 285 of Mr. Hutchens' trial testimony -- now
9 remember, at his deposition, Mr. Hutchens pulled the Sergeant
10 Schultz commonality, too, of I don't remember anything about
11 this deal. But here, this is the best they have, it's the
12 closest they've come to Mr. Hutchens giving them this, and
13 Mr. Rakhunov objected, it was overruled, I think it was getting
14 near the end of the testimony, but the question was, I'm
15 looking at the final document -- this is Mr. Hess asking --
16 that was signed for contribution, and liability, and
17 satisfaction amount. This is on page 280. And I'm asking,
18 "What, if anything, occurred in the conversations that occurred
19 on April 15th" -- it's fairly leading to say on that date --
20 "but looking at the final, but goes back to April 15th, after
21 you had sent your draft, led to the adoption of this language
22 instead of the language that had been advanced by Mr. Pecci?"
23 Objection is overruled.
24 "Answer: You know, I think is the case in many
25 transactions with continued discussions, you know, finally get

1 everybody right on the same page. So I think it would -- at
2 one point, we explained to them why it had to work this way and
3 how this reflected the economic terms of the original deal
4 agreed upon in the letter still being consistent with that, and
5 it was understood, and that's why it happened because this
6 works the same way."
7 What is that? That's not, well, we started off by
8 telling them, hey, just so you're aware, I just inserted the
9 tax allocation agreement not just in brackets, not just in the
10 stock purchase agreement, but actually into the waterfall, and
11 here's what it means. Because it never happened, your Honor.
12 And we know it never happened, and they want to take some notes
13 of Mr. Krauss' out of context because Mr. Hutchens never
14 testified he said it the way they're in the notes, and the
15 notes, it talks about a taxable value of NOLs. This is so
16 telling, your Honor. It's during the discussion of the stock
17 purchase agreement. Mr. Krauss explained that he wanted the
18 definition of what Kingsway was bringing to the table in return
19 for the equity that they were getting, and that's where it fits
20 there, it just fits. The stock purchase agreement is discussed
21 down the line section by section, including what each party was
22 bringing to the table. And then when it gets to the MSA, it's
23 50/50 after taxes and contributions, just like your Honor heard
24 at trial. And I remember you turning to Mr. Swets, your Honor,
25 and saying, but you just said taxes. Does that mean actual

1 taxes? And he couldn't even give a straight answer then, your
2 Honor, at a time when he's had three years to prepare, and it
3 seems like everyone before trial was studying Mr. Krauss'
4 notes, not their own.
5 And, if you remember, I read Mr. Hutchens' notes in my
6 initial summation, and that said, everybody knew, so we didn't
7 focus on the need to pay dollar-for-dollar. That was his
8 testimony when he was asked the specific question, not led with
9 the way Mr. Hess asked it in that -- where -- I mean, that's
10 gobbledygook. That means more when he says I just don't
11 remember.
12 I only have a few more things, a couple of substance
13 and a couple of just corrections. Keep in mind, Kingsway
14 closed the deal. Mr. Hickey said, I wasn't really satisfied
15 with the tax due diligence, but I'm going to say, your Honor,
16 nobody actually testified, I had no idea there was no inside
17 tax basis until June. Mr. Hickey actually said, at that point
18 we wanted to make sure Mr. Bates, the tax lawyer for CRIC, was
19 on the same page about that. There's no email internally, at
20 least not that's been produced to us, because sometimes
21 business emails copy a lawyer, but there is no email or other
22 internal conversation that's been described that says, guys,
23 oh, no, there's no tax basis, now it's very different. In
24 fact, what your Honor sees is a belated effort to go back to
25 Mr. Savelli in November saying, hey, you previously showed us

1 documents showing no inside tax basis, we just want to make
2 sure that's right. They're creating a record at that point
3 when they're also pushing Mr. Schwartz to propose an amendment
4 to the MSA, but you don't even have to get there, your Honor,
5 because I think the plain language of these agreements actually
6 require you to consider the second tax allocation agreement,
7 which didn't require any payment that would be owed to
8 Kingsway, and they've disavowed, during this trial, the third
9 tax allocation agreement. They specifically asked you not to
10 consider it. I get why.
11 THE COURT: They did?
12 MR. POLLACK: Well, he did. He has said a number of
13 times, we're not relying on the third tax allocation agreement,
14 we're relying on the second. Mr. Hess has said that multiple
15 times in opening, throughout the case, and in closing. They
16 said they're relying on the second and claiming that the third
17 just didn't change anything, but now we've heard it added an
18 express obligation to pay, and I think they're just ignoring
19 the words that said owed to KFS, because it has to be owed, not
20 just some theoretical liability under apportionment
21 regulations.
22 So he mentioned that CRIC, a related party, received
23 some of the funds. Just for the record, CRIC2 Funds is not
24 actually related, at least not beyond Mr. Schwartz intending to
25 do deals. This is more substantive. Mr. Hess says, no, take a

1 look at the way we did Demonstrative 1, that shows we thought
2 the management services were worth $28.8 million. First of
3 all, Demonstrative 1 was a trial creation. That wasn't how
4 people presented things. There is no evidence people presented
5 it that way. But if they really think that those services were
6 worth $28.8 million, and they were worth more than the actual
7 strike price in the letter of intent, and you heard that the
8 management services replaced the strike price. That's been our
9 position. It's consistent with the documents. I don't know
10 that anybody said the words, we're making a fundamental
11 economic change. Your Honor doesn't have to look beyond the
12 documents to see there was a fundamental economic change.
13 There's no longer a strike price. Instead, there are
14 management services, which now Mr. Hess says were actually,
15 according to Kingsway, worth more than the $20-million strike
16 price, and in the $20-million strike price, they didn't intend
17 to double charge, but here they try to find a way to do that by
18 amending the second tax allocation agreement. I think they
19 fully intended to rely on that third tax allocation agreement
20 until all the facts showed how bad it was, your Honor, and now
21 they're trying to distance themselves from it because it just
22 looks awful for them to rely on that. They did it at the time
23 to get leverage in this.
24 I think maybe Mr. Swets always -- the evidence strikes
25 that he is the kind of person who just renegotiates deals, but

1 he might actually renegotiate deals, it could happen. You've
2 seen with the other minority stockholders, they came up with
3 some change in the earnout and whatever, but Mr. Stilwell
4 didn't approve any of them here. So even if Mr. Swets had the
5 idea, well, if I get enough, I'll just rework the deal, rework
6 the deal, until everyone gives in, otherwise they can wait
7 17 years, but it just didn't get the approval internally from
8 the guy who wanted every last penny of the payments for the
9 NOLs that the third tax allocation agreement could create, and
10 it's only more recently that they distanced themselves from
11 that.
12 I will say that, for that reason, the testimony by
13 Mr. Hutchens, which I read to your Honor in my opening
14 summation, makes clear that their position, not that there was
15 no value to them, but they've certainly downplayed it in a way
16 that suggests it was done for the IRS on the face of it, and
17 that's how Mr. Hutchens' answer read. And that means to accept
18 their answer is to accept the version of this which is less
19 susceptible to a proper consolidation. They decided not to
20 produce the tax opinion letter in this matter. I guess that
21 was their choice, depending on how it's written, whether it's
22 privileged or not, but they certainly acknowledged they got a
23 verbal approval of this for consolidation purposes from the
24 very firm that they're relying on for the answer I read to you
25 at the beginning of this rebuttal summation that doesn't really

1 say anything, but is attempting to justify whatever is in that
2 tax opinion letter.
3 They say Mr. Swets told Mr. Schwartz that he was going
4 to pay dollar-for-dollar back at the time of the LOI. And,
5 first of all, to the extent Mr. Swets came close to that, it's
6 just not credible. But even then, the numbers went from
7 40 million to 20 million, and I think they say it was just
8 meant to be an estimate, not a dollar-for-dollar. Then we hear
9 this new -- Mr. Hutchens didn't actually say that the brackets
10 were just meant, it may or may not happen. Mr. Hutchens
11 actually said, and he's the drafter, we just would have cleaned
12 it up by the end, so there wouldn't have been double billing
13 like we ended up doing with the management services.
14 But Mr. Hames, I guess, is now an expert on brackets
15 in transaction documents, but relating back to the letter of
16 intent and the early stock purchase agreements, Mr. Swets
17 wasn't saying -- he never testified and said, I made them aware
18 of dollar-for-dollar, and that's what's going to carry through.
19 In fact, what you see is, in D5, Mr. Swets' admission, Terracap
20 was unwilling to agree to the original form of the
21 understanding. They bring up Mr. Pecci's edits that try to
22 capture whether it's that 3.8 million in losses that appear in
23 P100. I don't know how they could deny this. P100, there's a
24 tax return that showed 3.8 million in losses. There has been
25 testimony that they thought it was going to be larger than

1 that, what they would be able to rely on.
2 Granted, there may have been limits, as parties and
3 witnesses have testified to, on the use of it after an
4 ownership change, but Mr. Pecci was trying to capture this. He
5 testified, he testified consistently, that he was trying to
6 capture — and this is what the language says — the net
7 operating losses of the company, CMC Industries, that were
8 enjoyed by Kingsway, not the flip.
9 I have a couple of more things, your Honor.
10 They show that they sent over the second tax
11 allocation agreement on March 25th and used that to suggest,
12 well, how could that say that Mr. Stilwell reengaging had
13 anything to do with adding this into the transaction. To be
14 clear, on March 25th, the tax allocation agreement is referred
15 to -- I believe it's in the stock purchase agreement, it is not
16 in the waterfall for the CLSA. That gets added on April 15th,
17 eight days after Mr. Hames' observations. That's when this
18 whole scheme starts coming into fruition. It just is. There's
19 no explanation for doing that, other than Mr. Hutchens, sort of
20 wild, at some point, we did it, and, of course, we get on the
21 same page type of language, but nothing specific that says this
22 is what we described. And even sending that second tax
23 allocation agreement, they now admitted, it had no payment
24 obligation. And the language, ultimately, still in front of
25 your Honor, says, owed to KFS, not just something we can

1 somehow call a liability.
2 I'd say they referred to Jason Simkin to try to, I
3 guess -- who we haven't seen, we haven't heard from, but I
4 think Mr. Hames made clear that everything being done
5 internally even preexisted his arrival, so certainly preexisted
6 the second tax allocation agreement. I've already gone over
7 why that example in the second tax allocation agreement
8 involving 1347 Property Insurance Holdings offers nothing,
9 other than the meaning of the transition service agreement
10 there, and Mr. Hames' effort to minimize tax exposure for
11 Kingsway, and how he classified a compensatory payment under
12 the transition services agreement as a prepayment of tax
13 expenses, which completely contradicts 1347 Property Insurance
14 Holdings' SEC filings.
15 Finally, two things, your Honor. One, just another
16 point on Mr. Hess saying this doesn't really have any bearing
17 on the other parties. Just to be clear, we've gone over it,
18 that this is the second case Kingsway filed in New York Supreme
19 Court. It was removed. Mr. Krauss and Schwartz were dismissed
20 on personal jurisdiction grounds. It dealt with tax issues in
21 the hundreds of thousands of dollars, and this is in the public
22 record, so it exists.
23 But, importantly, and your Honor has seen it recently,
24 when Kingsway tried to tap into the escrow account, the parties
25 agreed to a standstill on certain issues involving the other

1 parties, but also agreed that they were in privity with the
2 parties in this case for collateral estoppel purposes.
3 So, in the public record at the end of the case that
4 your Honor still probably wishes, maybe now more than ever,
5 that this had been assigned as a related case, but the parties
6 agreed that they were in privity with each other for collateral
7 estoppel purposes when they come back to other issues, which
8 would include not only those small straddled period tax issues,
9 but also the back end that would go to CRIC. There's a
10 back-end portion going to DGI, which is directly at issue here,
11 but the portion going to CRIC adds a 19 percent if and when
12 there would be anything ever left over for CRIC that is subject
13 to collateral estoppel here by the agreement of the parties.
14 Finally, with regard to Mr. Hess' representations
15 about what the trial testimony was, Mr. Krauss did not say that
16 it was his idea to use 50 percent of the NOLs as some
17 measurement on a default. He testified that Mr. Savelli's
18 reference to Larry, probably, probably meant him, but that he
19 didn't agree with the characterization where Mr. Savelli was
20 someone peripherally involved in this. I don't know that
21 everybody testified to it, but nobody testified inconsistently
22 with the idea that the Article 15 of the stockholder agreement
23 morphed over time into something that became intended as a
24 penalty. I wasn't involved in that, your Honor. I know that
25 using that word might not be helpful in enforcing it later

1 because contracts aren't supposed to have penalties in them. I
2 think it means the colloquial kind of penalty, not the this is
3 a fine. There is no way that anyone from Kingsway can sit on
4 the stand or under oath in front of your Honor and testify, in
5 good faith, that getting 50 percent of the NOLs would be a
6 penalty when they haven't been able to move them, couldn't move
7 them to CVS at even 60 percent, which they tried to do through
8 Mr. Dochter.
9 And the final language just is what it is. It gets
10 back to the CLSA definition, and, you know, your Honor,
11 sometimes karma just comes around, because I think it's
12 pretty -- I won't say I think. The evidence shows it's pretty
13 clear here that there was an effort late in the game to try to
14 change this, both before signing, and I think they're pushing
15 their knowledge of a lack of inside tax basis, and the record
16 just is not clear for your Honor, other than in June, it was
17 confirmed. It's not clear on what people knew in March, April,
18 and May, but even let's say it's not known -- not really fully
19 understood until June. They went ahead and closed, and they
20 closed despite Mr. Hickey saying he was recommending they not
21 close because they weren't finished with their tax due
22 diligence. Why? Because they had done what they did with this
23 definition of the CLSA in a way that they thought, but they
24 mispredicted would work. And as they got closer, instead of
25 being 17 years down the road, when it would be easier for them

1 to get away with this, and who knows where Mr. Schwartz or
2 Mr. Krauss would be, they're facing it months later. And what
3 do they do? They go through these machinations of amending the
4 third tax allocation agreement the way they did. Planning to
5 use it. But it just looks so bad when the evidence started
6 coming out about it, that now they've distanced themselves from
7 it. I don't blame them for distancing themselves from it.
8 I would say, your Honor, in closing, on the plain
9 language of the contract, I think with the admissions that have
10 now come in, the second tax allocation didn't require a
11 payment. They said they're not relying on the third, but if
12 your Honor even goes through the exercise of considering the
13 third, despite Mr. Hess saying that they're not relying on
14 that, you couldn't have more equitably fraudulent or
15 inequitable conduct than someone who's not yet appointed an
16 officer signing the document before the meeting, not bringing
17 it to the meeting, sending the resolutions over in the last
18 hours before it, and planning in the background what's coming
19 out of there, heavily lawyering, but they don't us about, while
20 Mr. Swets writes to Mr. Schwartz text messages that talked to
21 him about how complicated a deal this is, but we're going to
22 find solutions, we'll just keep working together, just go amend
23 the MSA and we'll get this done. That's as inequitable it
24 gets. So, either way, the declaration should be that the CLSA
25 does not include payments for tax savings under the tax

1 allocation agreement as a debt, liability, or obligation owed
2 to Kingsway because it's not.
3 If, for some reason -- and the specific performance
4 just follows that up. I heard Mr. Hess say, well, they would
5 get quarterly payments. Well, then, where are they? None has
6 been made, not a single one. You heard that testimony, your
7 Honor. They have no evidence that they've made a payment, but
8 the cash is building up there. We know, from a related case,
9 that there is roughly $5 million built up. They wanted to take
10 Kingsway attorney's fees for Kingsway's counsel out of it.
11 So, your Honor, for that reason, specific performance
12 should be granted.
13 I want to hit one more thing, because Mr. Hess' answer
14 to your question, what if you find there wasn't a meeting of
15 the minds. You know, your Honor, it's possible to make that
16 finding, but I don't think that's what the evidence supports.
17 The evidence supports that parties have different
18 interpretations of the agreement, that there was a unilateral
19 mistake, if anything, if you have to get beyond just the plain
20 language, that Kingsway engaged, and caused TRT to engage, in
21 inequitable conduct to cause.
22 Either way, where DGI is entitled to the declaration,
23 it's entitled to that confirmation that the waterfall does not
24 include apportionments or allocations, it doesn't include tax
25 savings, it just includes actual taxes owed to KFS. That's the

1 language in the agreement. If you have to go beyond that, your
2 Honor, this is classic equitable fraud, and your Honor can
3 reform that agreement to make that clear.
4 And I think, as well, and I think the equitable
5 reformation hits even more on the monetization, which, if you
6 follow -- just if you view the text messages between Mr. Swets
7 and Mr. Schwartz, you're going to see the evolution of that,
8 and it gets approved, so, obviously, it's in TRT's interest to
9 have it, but Kingsway gets in the way of the very monetization,
10 the very refinancing that I go back to P36, Mr. Swets said to
11 Mr. Schwartz, I don't know how to put it in the document
12 without tax opinion letter issues — that's just not true — just
13 trust us, quote, trust us. Well, that's the exact situation
14 where your Honor gets to reform a document consistent with the
15 parties' reasonable expectations. So while there are
16 appearances of a lack of the meeting of the minds, it's not
17 really. There may be ambiguities, but they can be resolved on
18 the extrinsic evidence here, particularly with respect, if your
19 Honor has to invoke equitable reformation with even the ability
20 to say then that the monetization itself has been prevented, in
21 violation of the duty of good faith and fair dealing, given the
22 promise, trust us, we'll get it done, given the whole
23 expectation Mr. Schwartz and Mr. Krauss had that they were
24 going to share in the bulk of that upfront payment that was
25 approved. And even Mr. Swets said, I know that CRIC gets that

1 on the front end. I know he said 75/25, he meant 80/20, but
2 even he said it because that was the deal, and he did not --
3 despite the games being played for the back end, he did not
4 realize that his team would get together with him to put up
5 these same arguments for the front end as well, not until after
6 they've dug in a little further, and remember, then they
7 amended the second tax allocation agreement to the third tax
8 allocation agreement.
9 It's clear, your Honor, and I don't have to go through
10 each and every line and each and every agreement, that gets to
11 be a frolic. The important ones, your Honor has seen. There
12 are explanations. The explanations by Kingsway just don't make
13 sense, your Honor. They wouldn't make sense. So I ask for
14 judgment in our favor, as well as attorney's fees, because
15 we've seen TRT take Kingsway's position, not TRT's.
16 Thank you, your Honor.
17 THE COURT: So your argument is that the CLSA
18 definition is not ambiguous, and that, therefore, a
19 declaratory --
20 Could you leave it up? Mr. Rakhunov, can you put it
21 back up, please. Thank you.
22 So your argument is that this is not ambiguous, and
23 that, therefore, the Court could declare that the owed to KFS
24 means an actual (unintelligible), and that's not included in
25 the second tax allocation agreement, slam, bam, thank you,

1 ma'am, you win.
2 MR. POLLACK: That's our primary argument in light of
3 the admissions that have now been made. I think if your Honor
4 thinks owed to KFS ends up somehow ambiguous somehow, the
5 extrinsic evidence supports us in every way.
6 THE COURT: I understand that's your argument. If I
7 find that it's ambiguous, then I look to the extrinsic evidence
8 of what was the parties' intent. Suppose I come down on that
9 saying there was not a meeting of the minds?
10 MR. POLLACK: I think your Honor looks for reasonable
11 expectations of the parties as evidenced by their
12 manifestations.
13 THE COURT: In which case, I rely on that email from
14 Mr. Swets saying he knows that CRIC gets 80 percent of the
15 front end, which --
16 MR. POLLACK: He said 75, but, yes.
17 I think that's the first thing to look at, but you
18 also have Mr. Krauss' and Mr. Schwartz's descriptions of what
19 the parties were discussing along the way, and you have,
20 essentially, admissions by every Kingsway witness that they
21 don't remember a specific conversation, and I read the closest
22 thing Mr. Hutchens said. I think we saw it at trial when
23 Mr. Swets would start saying taxes, it didn't describe tax
24 savings. But, yes, there is a hierarchy of evidence at that
25 point, and I think your Honor's job, in a contract like this,

1 there is not a failure for a meeting of the minds just because
2 there are different interpretations of a contract. It's the
3 job of the Court, as a matter of law, to interpret either the
4 plan language, or if it can't do it off the plain language, to
5 look at extrinsic evidence to enforce the reasonable
6 expectations of the parties.
7 And when I say after Mr. Swets' comment, you have
8 Mr. Hutchens' comment that says everybody knew, so we didn't
9 talk about it. But then I think, even more importantly, his
10 description that would make it an agreement more susceptible to
11 suspicion by the IRS if the management services were not
12 actually a replacement for the $20-million strike price. And I
13 think that the -- if your Honor looks at the documents and
14 accepts that the management services were what entitled DGI to
15 that 40 percent that would bring the economics to 50/50, it's
16 got to be because those services were as valuable as the
17 $20-million strike price, if not more valuable. And remember,
18 they've testified that they weren't going to double charge
19 beyond the $20-million strike price. So the management
20 services just replaces the $20 million, which Mr. Hutchens
21 said, effectively, yes.
22 I think that ends the extrinsic evidence inquiry. And
23 you can look at the fact that it gets added to the tax
24 allocation agreement on April 15th and what surrounds that, but
25 I do think that there are several layers of evidence that would

1 provide the extrinsic evidence, as well that it's not
2 reasonable to expect getting paid a-dollar-90 for each dollar
3 of NOLs as the economics when parties keep saying to each other
4 it's 50/50, it's 50/50, it's 50/50.
5 THE COURT: I hear you, but, again, what's the answer
6 if -- after I go through all this again and review all the
7 testimony again, I am left with an abiding sense that the real
8 problem here is that the parties do not -- did not have a
9 meeting of the minds; that is, the Kingsway people genuinely
10 understood and believed that what they were getting was lots of
11 bells and whistles plus essentially an obligation from CMC that
12 they would get paid at the time the property was sold for
13 dollar-for-dollar reimbursement of their NOLs, and that
14 Schwartz and Krauss genuinely did not understand that that was
15 what was happening, that what they believed was that other than
16 out-of-pocket payments by Kingsway, that this was a 50/50
17 allocation of the free cash at the end of the transaction.
18 MR. POLLACK: I think the right thing for your Honor
19 to do is there's a difference between having different views of
20 what these documents end up meaning and how the mechanics would
21 flow than there is a lack of meeting of the minds. I think
22 your Honor has to look at whether one party was unilaterally
23 mistaken by another party's superior knowledge. So I think
24 that takes you to the equitable fraud issue as well, where they
25 were in a superior position to know. There have been

1 statements made by them that, for instance, just having the
2 $20-million strike price along with the tax sharing agreement
3 in a document would be implying there's no additional payments
4 being required under the tax sharing agreement. I still say
5 the second tax allocation agreement doesn't require payments,
6 so there's nothing owed to Kingsway.
7 But I think your Honor's task is then to enforce the
8 reasonable expectation of the parties under the circumstances.
9 As your Honor said, for instance, I guess the one place I can
10 see a difference in that from our two requests for relief —
11 and, again, your Honor has broad equitable powers — is that
12 there could be a way in which your Honor would say, well, the
13 front end of this transaction, now that there has been a lease
14 enhancement, clearly the reasonable expectation to the parties
15 on that part of it was that it could be monetized and that it
16 would be 80/20, and even Mr. Swets admits that. And that would
17 resolve that part of the case for today, while leaving open the
18 question of what happens on the back end.
19 There may be collateral estoppel on findings, there
20 may not be, but it would take care of that issue now, it's
21 ripe. I don't think there's any way to look at this evidence,
22 your Honor, and not think that the reasonable expectations of
23 DGI was to receive 80 percent of the lease enhancement
24 without -- after the 1.5 million that's there and any actual
25 taxes or expenses.

1 And that's -- I mean, Mr. Swets was marching
2 Mr. Schwartz off on a futile exercise to hurt himself and take
3 away the possibility of a huge sale down the road, so that
4 Kingsway could get something up front and DGI would get
5 nothing. That just doesn't make sense, your Honor. That's not
6 a reasonable expectation. The reasonable expectation is right
7 in Mr. Swets' email. I know CRIC gets the front end, but I
8 don't want it to happen to the back end. Your Honor could
9 limit your ruling, for the time being, to the front end, rather
10 than get into what happens in the back end, but certain
11 findings of fact, the parties have agreed, would be subject to
12 collateral estoppel.
13 THE COURT: Let me just ask Mr. Hess one more
14 question. Thank you, Mr. Pollack.
15 Mr. Hess, one more question, and that is: Why isn't
16 the email from Swets saying they get 80 percent of the front
17 end of this deal, I'm just worried about what's happening on
18 the back end, really fatal to your argument, or is your
19 argument Swets didn't understand the deal?
20 MR. HESS: Well, your Honor, Mr. Swets testified, and
21 actually Mr. Hickey corroborated this in his testimony, that he
22 wrote -- you have to look at the context in which he wrote that
23 email. He had had a conversation with Mr. Schwartz just prior
24 to sending that email to his team. Essentially, what was going
25 on right then, from Mr. Schwartz' perspective, is that he was

1 expressing seller's remorse, if you will, in that he came to
2 the conclusion that --
3 THE COURT: No. I'm focused on Swets, Swets' state of
4 mind. Why isn't that email detrimental, incredibly
5 detrimental, to your argument that the understanding on the
6 Kingsway side from the get-go was that they were getting
7 100 percent on the dollar for their NOLs? Because, if so,
8 there is no way he would say that the lease amendment is going
9 to go 80 -- he said 75, but 80 percent to CRIC on the front
10 end, and he was okay on that. He was just worried about the
11 back end.
12 MR. HESS: Your Honor, the point I'm getting to is
13 that Mr. Swets had this conversation with Mr. Schwartz, and
14 Mr. Schwartz, having realized that for him to get the money, he
15 thought he should get out of the lease amendment, what he would
16 have to do would be to monetize it, so that the only value of
17 NOLs that CMC Industries had to pay off were those that
18 Kingsway used to that point, which was a few hundred thousand
19 dollars. So, basically, what Mr. Schwartz was proposing to
20 Mr. Swets is you take this $25-million lease enhancement, it
21 works out, so that we can monetize it for 20 million, and of
22 that 20 million, you get about 5 million for your $1.5 million
23 and your few hundred thousand dollars in NOLs and your
24 20 percent interest, we get about $15 million for our 80
25 percent interest after deducting your 1.5 million and the few

1 NOLs you've used to that point. So what Mr. Swets testified to
2 is that he was restating to his team what Mr. Schwartz had told
3 him. The only problem with that, from Mr. Schwartz'
4 perspective, was that the way that waterfall worked, the value
5 of the additional $20-million loan would be part of the
6 waterfall, so that just because of the mechanics of the
7 document, it would be worth -- it would work out in such a way,
8 that without an amendment, even with monetization, there
9 wouldn't be money.
10 Mr. Swets tried to work something out. He offered
11 Mr. Schwartz a $5-million payment, and there were some
12 discussions going back-and-forth.
13 THE COURT: So I have to -- in order for that not to
14 be a bad document for you, a really bad document for you, you
15 have to credit Swets' explanation that he was just parroting
16 what Schwartz had told him.
17 MR. HESS: Yes, your Honor.
18 And, also, look at the top of the email chain where
19 Mr. Baqar explains, specifically, how the document actually
20 worked.
21 THE COURT: Right. But, again, that would mean that
22 Swets didn't know how the transaction worked, the notion that
23 everyone always understood how it was working.
24 MR. HESS: I'm sorry, your Honor. What Mr. Swets
25 didn't understand, until Mr. Baqar and his team explained it to

1 him, was that if there were monetization, the value of that
2 loan taken against the $25 million would become part of the
3 waterfall, which would block DGI from getting any service fees.
4 That's getting in the weeds, that's not about the NOLs.
5 THE COURT: As I recall, what I heard that at the
6 time, I don't believe that that is actually what the language
7 says, because the amount of the loan wasn't due at that point.
8 MR. HESS: Your Honor, on that very issue, Mr. Hickey
9 made an incorrect statement because he was trying to interpret
10 the documents on the fly. So, the amount of the $180-million
11 loan is not part of the waterfall. Mr. Hickey thought it was.
12 The $20-million loan would have fallen into the waterfall, or
13 that amount would have fallen into the waterfall with respect
14 to one of the specific terms -- I can't recall if it was BNSF
15 transaction or lease transaction, one of those, it would have
16 been included. But we can address that in our papers.
17 MR. POLLACK: Your Honor, can I just ask one thing?
18 Can we put up P38? I just want to see one thing in response to
19 Mr. Hess.
20 THE COURT: Okay.
21 MR. POLLACK: If Mr. Rakhunov can put up P38.
22 This is the email. It doesn't say anything about Leo
23 told me. It says, very matter-of-factly, of course, CRIC wants
24 to do it as they get 75 percent of 25 million. It relates
25 directly back to the promise to trust us.

1 I think it happens that people like Mr. Swets, who
2 engage in various ways to set themselves up to renegotiate and
3 change things, they can't always keep things perfectly
4 straight, but this is an admission. The explanation that I was
5 parroting, he didn't say to your Honor, you know, I rattled
6 this off so quickly, I made a mistake. He decided to go under
7 oath saying to your Honor, I was just parroting Mr. Schwartz.
8 That's not what happened here.
9 And then their best explanation is, yeah, but look
10 beyond Mr. Swets for Kingsway, look at what Mr. Baqar says when
11 he takes a look at this. Mr. Baqar is the guy who said, oh, I
12 want nothing to do with this deal, but all of a sudden,
13 Kingsway's intentions is supposed to turn on Mr. Baqar's
14 battlefront explanation of how they can get more leverage over
15 DGI. That's just not right. Mr. Swets was the principal
16 negotiator. This is what he said. If your Honor thinks that
17 there is an ambiguity beyond the -- and I do think there can be
18 ambiguous parts of the CLSA, but they haven't refuted that
19 under the second TAA, there's nothing owed to KFS by the
20 subsidiary, so that's where you get plain language. But if
21 your Honor gets caught up on any other ambiguities, this does,
22 I think, put the nail in the coffin for Kingsway's position,
23 though I do think we have the other things I've raised, your
24 Honor.
25 THE COURT: Can you scroll up, Mr. Rakhunov.

1 MR. POLLACK: If I may, when your Honor finishes that.
2 THE COURT: Okay. So this would affect if they had
3 monetized the added cash flow, then that would be defined as
4 other debt of the CMC group, but they haven't monetized it,
5 largely because -- I think largely because there seems to be a
6 misunderstanding of whether they could do that in a way that
7 would fully monetize the loan, if I understood what Hickey and
8 Swets were saying. But they haven't done that. So, right now
9 what you've got is increased cash flow, which is -- I mean, so
10 you win only if I agree that it's to be reduced by actual
11 payments or the value of the NOLs, and, even then, I would
12 think at this early stage of the loan, it must not fully wipe
13 out the added lease payments, or does it? No one is giving me
14 that accounting.
15 Do you understand the question?
16 MR. POLLACK: I think so.
17 I do want to point out that the gist of Mr. Baqar's
18 argument about what the bank would sweep is just fundamentally
19 wrong, and there is cash sitting in there, as your Honor knows
20 from the related action.
21 And this does actually make me think, your Honor is
22 talking about parsing apart aspects of this, I think, and how
23 it might work if your Honor is thinking there's no meeting of
24 the minds. I do want to stress there's something that maybe is
25 slipping through here, which is going to the third tax

1 allocation agreement, and I'm concerned your Honor may go there
2 even though Kingsway says that they're not relying on it, but,
3 remember, there are fiduciaries who are self-dealing, and I
4 gave the citations on the stockholders' agreement the kind of
5 approval that's needed.
6 THE COURT: I would not spend a lot of time on the
7 third tax allocation agreement if you're correctly stating that
8 Mr. Hess has argued, and the defendants have argued, that
9 they're not relying on it, because I think the circumstances
10 under which it was adopted make it extremely dicey for the
11 defendant.
12 MR. POLLACK: Okay.
13 THE COURT: I think to the extent there is value in
14 it, it's by comparing it with an expressed paragraph that says
15 you actually have to pay dollar-for-dollar. The fact that that
16 language is not in the second agreement suggests that there was
17 a change. And I recognize that Mr. Hames testified that there
18 wasn't a change; on the other hand, I don't have any evidence
19 other than his testimony of that fact. And what I do know is
20 it's not required as a matter of tax law. It doesn't make any
21 sense to require it as a matter of tax law for there to be
22 intersubsidiary transfers of cash to (unintelligible) entities
23 of a qualitative group for the use of NOLs.
24 MR. POLLACK: Your Honor, where I was going, though, I
25 think it's pinpointed, if your Honor is thinking that there is

1 a lack of the meeting of the minds or how this played out in
2 those months in October, November, December, I think a burden
3 should shift to Kingsway as having their appointed fiduciaries
4 controlling these transactions to justify the entire fairness
5 of what they were doing at the time in the overall transaction.
6 THE COURT: I think that's a different lawsuit. I
7 hear you --
8 MR. POLLACK: It might be.
9 THE COURT: -- but I think that's a different lawsuit,
10 although, god knows, I'm not suggesting it, unless it's going
11 to be filed somewhere other than the Southern District of New
12 York.
13 Mr. Hess, did you want to saying something?
14 MR. HESS: Yes, just one note on P38. It seems your
15 Honor saw this, but just to be sure. So it's the threshold
16 amount including this $1.5 million, plus all capital
17 contributions, plus any other debt of the CMC group.
18 THE COURT: Yes.
19 MR. HESS: So it's that. And these are the CLSA, but
20 it's this any other debt that would encompass the value of the
21 additional loan taken against the rail yard.
22 THE COURT: If they did that, but they haven't done
23 that. So, right now, that's not something that gets added into
24 the threshold amount before you figure out what you're doing
25 with the excess cash.

1 MR. POLLACK: Remember, your Honor, it's in the
2 disjunctive, and it does say then due and payable. Threshold,
3 the definition of threshold amount, which when you asked
4 Mr. Hickey about it, he got silent. I remember we were
5 waiting, it felt like a full minute, for an answer, and there
6 was no answer, and we moved on.
7 MR. HESS: Your Honor, this is not a direct quote --
8 THE COURT: I don't think that's -- that was not the
9 one, but maybe it was.
10 MR. POLLACK: I'm in the threshold amount, and it
11 says -- it has that "see the aggregate amount of any principal
12 interest and other amounts then due and payable." That
13 language is right in the definition of threshold amount, P7.
14 THE COURT: It would get added; it is an addition into
15 the threshold amount.
16 MR. HESS: It would come in in the definition of the
17 CLSA, which is incorporated in the threshold amount.
18 THE COURT: Okay. My question is: There is clearly
19 excess cash. What's your argument why it's not getting paid?
20 MR. HESS: Your Honor, it's not being paid because
21 it's in dispute. Kingsway has sought payment for the use of
22 its NOLs, and that would -- and if there were eventually a
23 Court finding that Kingsway was entitled to that, then that
24 would be paid out from the escrow account. And --
25 THE COURT: How many NOLs have they used to date

1 versus what's sitting in that account?
2 MR. HESS: I can't say off the top of my head. I
3 think it's about 5 million in each case, but I can't say off
4 the top of my head.
5 So, basically, the value of the -- it's slightly
6 higher. The value of the NOLs Kingsway has used is slightly
7 higher. So if Kingsway were to ultimately prevail in a lawsuit
8 focused on whether CMC Industries has to pay Kingsway for the
9 use of its NOLs, then Kingsway would get all of the money in
10 the escrow account. So the money is sitting there, and,
11 conversely, if there were a finding that DGI is entitled to
12 80 percent of the net excess cash going through the waterfall
13 without deducting the value of the NOLs, then the money would
14 come out of that escrow account.
15 MR. POLLACK: Your Honor --
16 THE COURT: Hang on one second.
17 Mr. Barton, you are highlighting a document. Is this
18 a document that's in evidence?
19 MR. BARTON: Yes, your Honor.
20 THE COURT: What is it?
21 MR. BARTON: These are the projections, the November
22 projections prepared by the Kingsway team of how much
23 additional rent was going to come in versus what the
24 contribution and liability satisfaction amount would be under
25 the MSA. As you can see, they are projecting that, for

1 example, in 2017, the contribution and liability satisfaction
2 amount, if they did the BNSF transaction, would be $4 million,
3 while in 2017, there would be only 1.5 million in addition to
4 rent collected. Therefore, the applicable fee amount is zero
5 dollars.
6 Now, the numbers obviously change over time. There
7 were changes in tax rates and so forth.
8 THE COURT: Understood.
9 What exhibit is this?
10 MR. BARTON: Let me find that for you, your Honor.
11 You can see those numbers in tab 26 of the examination
12 binder, or tab 26A -- it's P53, your Honor, Plaintiff's 53, and
13 then it was sent to Leo Krauss.
14 THE COURT: Thank you.
15 I gave you dates when your revised findings of facts
16 and conclusions of law are due. Are the parties interested in
17 a settlement conference?
18 MR. POLLACK: Mr. Ruberry and I have had discussions.
19 I would think that if -- we will find out. The issues that
20 happened when we were before the Court, I think Mr. Ruberry and
21 I both agreed that principals in front of the magistrate judge
22 spent a lot of time arguing their positions, and it did not end
23 up narrowing the gap substantially.
24 MR. RUBERRY: I think to follow on our conversations —
25 and, Barry, correct me if I'm wrong — that it would make sense

1 to have a mediation with the --
2 THE COURT: A mediation with who?
3 MR. RUBERRY: Barry, do you recall?
4 We thought a person may be very knowledgeable in
5 insurance issues. That's the way I remember the conversation.
6 MR. POLLACK: We didn't discuss about insurance
7 issues. We discussed whether a private mediation would make
8 sense, and then we had certain discussions where it looked like
9 we were getting closer, but we didn't.
10 I think your Honor has given us a substantial amount
11 of time to do the proposed findings, the amended proposed
12 findings, which I think if the parties can benefit from that
13 time in some other way, we would certainly inform the Court if
14 we made progress or close to a resolution. I know there was a
15 lot of discussion just now, but I would like to not leave the
16 record without at least saying one sentence --
17 MR. RUBERRY: If I could respond there, if I could.
18 Excuse me, Barry.
19 Your Honor, Mr. Pollack discussed the concept with me
20 of mediation. I didn't go looking for it — I don't know if he
21 did — but he was the one that raised it, and I said that -- I'm
22 not saying a private mediator would be better than a federal
23 magistrate judge, but there was some concept in that discussion
24 that he raised. So that's where it came from.
25 THE COURT: That's fine. I don't really care. I'm

1 always in favor of lawyers talking to each other about
2 settlement or mediation, about a magistrate judge. Let me say,
3 however, that, in my view, I recommend you take back to your
4 principals that this case would benefit from settling versus
5 decision on the merits. Because you've both got substantial
6 risk associated with a decision on the merits, which would much
7 more likely end up being a zero sum game than negotiating a
8 settlement that both sides give a little.
9 You've got problems with whether there is going to be
10 collateral estoppel with what I decide, and, therefore, it
11 could affect you not just for the 25 million in added lease
12 payments that BNSF is paying now, but could affect you for the
13 entire deal 17 years down the road. So, this just strikes me
14 as a case where I don't know if your clients are being
15 hardheaded or haven't really met the -- Mr. Ruberry and
16 Mr. Hess, your client, because Swets got fired or left under --
17 the circumstances were not defined, and I don't care, but Swets
18 isn't there anymore. The only person that I saw that's still
19 at the company is Hames. I don't get the sense that Mr. Hames
20 is making decisions for Kingsway. Whoever is making the
21 decision for Kingsway -- again, I didn't meet the principals
22 who are on the other side for the plaintiffs, who seem like
23 perfectly reasonable men to me, and you've all spent a lot of
24 money on this litigation, but I'm just encouraging you to tell
25 your principals that at least the judge thinks this is a case

1 that would benefit from sitting down and trying to settle it,
2 finding a midway solution that makes everybody a little unhappy
3 and nobody a lot unhappy. There's still a lot of money to be
4 had in this, so it seems to me that there's more than enough
5 money to keep people happy.
6 MR. RUBERRY: Your Honor, that is very perceptive
7 Mr. Fitzgerald and Mr. Hogan, on two occasions, came out and
8 met with Magistrate Judge Moses. I think she found them --
9 they wanted to be at the trial, but for the quarantine, they
10 couldn't. But I think --
11 MR. POLLACK: Your Honor, some of this is getting
12 entirely inappropriate.
13 MR. RUBERRY: Barry, if you could, please. I didn't
14 interrupt you.
15 MR. POLLACK: You're about to discuss a mediation with
16 a fact finder, Mr. Ruberry, because that would be entirely
17 inappropriate, and I have some things I would say in response.
18 MR. RUBERRY: I don't know what he's talking about.
19 I'm just talking Judge Magistrate Moses found that my clients
20 were reasonable, that's all.
21 THE COURT: Okay. All I'm saying is I'm the fact
22 finder, and Mr. Pollack is right. I don't want to talk
23 settlement. I just, as always, am encouraging the parties to
24 talk to their clients about whether settlement isn't a better
25 solution, particularly given the fact that what I've got in

1 front of me is a small issue that could have much larger
2 implications to the overall relationship between the parties.
3 MR. RUBERRY: Thank you, your Honor.
4 And instead of me saying I thought my clients were
5 reasonable, that's what I was addressing. So the bottom line
6 is we have reasonable clients, and Mr. Fitzgerald and Mr. Hogan
7 is on the TV, so I believe they're very reasonable.
8 THE COURT: All right. Anything further, Mr. Pollack?
9 MR. POLLACK: I do. I do want to -- I object to
10 Mr. Ruberry's description. I would have a lot to say, but I
11 don't think it is appropriate to address this about what's
12 reasonable and what's not reasonable.
13 They did just go into some other documents. I just
14 want to leave you with a thought, your Honor, that if they're
15 going to take the position that Mr. Swets just had the deal
16 wrong, and that's how to read P38, that's an entirely different
17 problem for them, but it's a huge problem in any way about how
18 this P38 affects them.
19 THE COURT: P38? Which document is P38?
20 MR. POLLACK: That's the one where he says, of course,
21 CRIC wants to do it as they get 75 percent of the 25 million
22 because he's the guy who's negotiating the deal.
23 THE COURT: Mr. Pollack, I fully understand that
24 argument.
25 MR. POLLACK: Okay. So, with that, your Honor, I will

1 talk to Mr. Ruberry. We have certainly reached out for each
2 other as lawyers, just as a case that does involve big
3 transactions, that I think with what Mr. Ruberry and I have
4 discussed before, we both are in agreement that we would make
5 efforts to see what could happen. We've made efforts. We've
6 both agreed expressly that given the way things transpired
7 involving both sides in front of the magistrate judge, if we
8 were going to mediate, we would go to a private mediation. We
9 both agreed to that, and it wasn't that one was leading it, we
10 both had an agreement about it not working, and we had only had
11 like an hour and a half one afternoon, and where it went just
12 didn't work.
13 My reaction is that Mr. Ruberry and I should talk
14 again, and if it gets close, your Honor, we'll let your Honor
15 know if it's getting close. But so far, despite there being as
16 much as your Honor says, when there's a way of looking at
17 something 50/50, and 99/1, there might be a way to find
18 something in the middle, and sometimes there's not, your Honor.
19 THE COURT: Again, I got it. And I certainly -- trust
20 me, I will not take it as you dissing Magistrate Judge Moses.
21 Trust me, Magistrate Judge Moses is not looking for additional
22 work. I don't disagree with you that frequently privately
23 retained mediation, particularly for a case like this that is
24 going to require more than an hour and a half or two hours on a
25 few days, is probably more appropriate to be done in private

1 mediation.
2 So, I leave it to you. If you get close, and,
3 therefore, you need an adjournment of your time to submit
4 revised findings of fact and conclusions of law, all you have
5 to do is ask me, but if you're not, then I want to go ahead and
6 get them in, so that I can get the case resolved and off my
7 docket.
8 MR. RUBERRY: Thank you, Judge.
9 If I can say, your Honor just hit the nail on the
10 head. The whole concept was someone with unlimited time to
11 look at it. That was the whole thing, Judge. There was no
12 confliction at all.
13 MR. POLLACK: Absolutely, your Honor.
14 Thank you for your time and patience throughout this.
15 I have referred to it as going hybrid, like my kids at school,
16 where we were in person at times and then remote at times, and
17 I hope some of the glitches did not frustrate the Court too
18 much because this was a first in some ways for me.
19 THE COURT: Listen, it was a joy. You guys all did a
20 great job. It solidified in my mind, if it needed to be
21 solidified, that online hybrid learning is doing a grave
22 disservice to the children of this country, and it ruminated to
23 me that I can't wait to be back in the courtroom, where it's
24 much, much easier for my body language to communicate to you
25 what you need to know as lawyers. I truly believe this case

1 would have taken a week to try if we had been in a courtroom.
2 But we are where we are. We've done it.
3 So thank you very much. Have a wonderful holiday,
4 everybody. And I will see you on the other side, hopefully.
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