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

LIAN WU SHAO, Plaintiff, -against- TIANJI LI, NEW WORLD MALL (NY) LLC, SAM CHANG, NWM MEMBER LLC, and NEW WORLD MALL, LLC, Defendants.	Index No. 651886/2011

MEMORANDUM OF LAW IN SUPPORT OF PLAINTIFF'S MOTION FOR PARTIAL SUMMARY JUDGMENT

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PRELIMINARY STATEMENT

Plaintiff moves for partial summary judgment declaring that defendants have breached a Second Amended and Restated Operating Agreement among them, entered into on or about December 7, 2010 (the "Second Agreement"), and that the acts taken by defendants pursuant to and under the Manager Authorization Agreement, Irrevocable Proxy and Power of Attorney, all dated December 8, 2010, as described in the accompanying Affidavit of plaintiff Lian Wu Shao, be declared invalid. Although Plaintiff challenges the validity of the Second Agreement as fraudulently induced, that claim is not ripe for summary judgment, and the Second Agreement's validity is assumed for purposes of this motion. We ask that issues of appropriate relief and damages on the several causes of actions referable to this motion be addressed after its resolution.

Three business partners, defendants Sam Chang ("Chang") and Tianji Li ("Li") and plaintiff Lian Wu Shao ("Shao"), joined in an LLC in 2009, New World Mall LLC (the "Company"), to develop and operate property previously known as Alexander's department store in Flushing, Queens.[1] The Company entered into a master lease with Alexander's, which owned the property, and then began renovating the building and subleasing the floors to five separate retail businesses.

The Company's operating agreement, typical of LLCs, governed the rights and obligations of its members, including with respect to such basic issues as management of the mall, meetings of members, voting, capital contributions and the like. The agreement included provisions severely restricting the transfer of a member's interests, and included a "right of first

[1] Although the Company is a named defendant in this action, it is not a respondent on the present motion, and the term "defendants" as used in this brief is not intended to include the Company.

refusal" mechanism that gave each member notice and the right to purchase another member's interest before it could be sold to anyone else.

In December 2010, Chang and Li went behind Shao's back and made a secret agreement by which Chang would effectively transfer all of his interests and rights in the Company to Li, including an irrevocable proxy to vote his ownership interest. Chang and Li, however, were up against a problem in carrying this out. Fully aware that no member could "sell" his interest without offering it to the other members, in their secret agreement they constructed a sham "assignment" for "security" to attempt to mask the fact that Chang was irrevocably transferring to Li, for a substantial amount of money, all of his incidents of ownership in the Company. As part of their plan, they tricked Shao into signing a new amended operating agreement that removed restrictions on "assignment" or a "pledge" of a member's interest. Their secret agreement contained a security agreement that purported to reflect Chang's obligations for which the security was given, when in fact there were no such obligations.

By definition, an assignment of an interest for security is given by the assignor, for a period of time, to secure the performance of an obligation or pending the occurrence of a particular event. Here, Chang and Li of necessity tripped up: under the secret agreement they drafted, the assignment by Chang to Li secured nothing; to the contrary, in exchange for his assignment of the incidents of ownership, Chang received large monthly payments which he had no obligation to repay. Essentially, he "sold" his interest, and the attempt by Chang and Li to draft around this is transparently ineffective. Therefore, as shown below, as a matter of law, they

breached the terms of the new amended operating agreement.[2]

THE FACTUAL BACKGROUND

The background facts may seem complicated, but this motion for partial summary judgment turns solely on a reading of the parties' new amended operating agreement and the words of the secret agreement between defendants Chang and Li. Although not necessary to a resolution of the motion, this factual background provides a useful context for understanding the defendants' scheme.

The First Agreement

Shao, Chang and Li were partners in the Company. By an Amended and Restated Operating Agreement, dated February 16, 2009 (the "First Agreement"), Chang and Exceli-Star Development LLC (Exceli-Star"), a company jointly owned by Shao and Li (with one additional 5% partner, not relevant here), set forth their respective rights and obligations in the Company.[3] Chang owned 50.1% of the Company and Exceli-Star 49.9%; through their individual direct and indirect interests, Shao and Li in effect each held a 23.7% interest in the Company. The chart annexed to the Shao Aff. as Exhibit B depicts the ownership of the Company immediately after the First Agreement was executed. The First Agreement provided for a super majority vote of 75% of membership interests for a range of major ownership decisions. A unanimous vote was required to make management decisions for the Company, although Shao and Li served as day-

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[2] Given the record of defendants' acts, it is likely that if the Court grants this motion, defendants will seek to perpetuate their wrongful control of the Company by effecting an end-run around the Court's decision. Should this occur, we will seek appropriate relief from the Court by way of preliminary injunction or otherwise, based on the facts then presented.

[3] The original agreement was entered as of January 30, 2009. The First Agreement, in which Exceli-Star was admitted as a member, amended that agreement. The First Agreement is annexed to the accompanying Affidavit of Lian Wu Shao, sworn to April 25, 2012 (the "Shao Aff."), as Exhibit A.

to-day managers of the Company with respect to leasing and operation of the New World Mall. (Shao Aff., ¶ 4.)

"Transferability"

In a critical provision, captioned "Transferability," the First Agreement prohibited the transfer of a member's interest:

> **GENERAL. Except as set forth in this Agreement, no Member shall gift, sell, assign, pledge, hypothecate, exchange or otherwise transfer to another person any portion of a Membership Interest.**

Exhibit A, p. 13. The First Agreement went on to provide a mechanism by which, if a member *did* want to sell his or its interest in the Company, an "Offer to Acquire" had to be obtained from the prospective purchaser, followed by notice to the other member or members, who could then exercise a right of first refusal. With the protection afforded by this procedure, Shao, who invested more than $2 million of his own money in the New World Mall project, had no reason to suspect the conniving and deceitful conduct of his partners that would soon victimize him.

The Chang-Li Secret Agreement

In a secret agreement, purportedly made as of December 8, 2010, but, in any event, made in contemplation of the soon-to-be-signed Second Agreement, Chang irrevocably "assigned" his membership interest in the Company to Li, in return for which Li paid Chang the sum total of Chang's capital contributions -- $1,520,000 -- and agreed to pay Chang an additional $50,000 per month (the "Secret Agreement"). (Shao Aff., ¶ 6 and Exhibit C.)

Besides this irrevocable "assignment" to Li of his membership interest in the Company, Chang also assigned his right to profits, return of capital contributions and managing and voting rights to Li, granted Li an "irrevocable" proxy and a power of attorney, and entered into a Manager Authorization Agreement authorizing Li to make "any and all necessary decisions" that

Chang "would otherwise be empowered to make."[4] That appointment also is "irrevocable."

Finally, the "Term" of the Secret Agreement is defined as follows:

> "Term" means the period from and including the date of this Agreement through and including the expiration date of the Lease Agreement dated January 23, 2009 or any and all renewal terms thereof for the Premises between Alexander's of Flushing, Inc., a Delaware corporation, as Landlord and the Company as Tenant, whichever is later.

(Shao Aff., Exhibit C, p. 2.) Thus, while the Lease Agreement for the mall between the Company and Alexander's extended to 2027, the purported "assignment" from Chang to Li could well be in perpetuity, since it would continue for "any and all renewal terms" of the Lease for the mall.

A pivotal provision of the Secret Agreement is in "Article IV," "Contigency," p. 8 [sic; it should say Article IX]. That provision made the entire Secret Agreement contingent upon execution of an amended version of the First Agreement satisfactory to Chang and Li. The Secret Agreement was to become effective only upon execution of the Second Agreement -- in other words, only after Shao had been duped into agreeing to seemingly innocuous changes to the First Agreement that, unbeknownst to Shao, would eviscerate his rights in the Company by giving Li unfettered ownership and managerial control. The "Contingency" clause in the Secret Agreement reads as follows:

> This Agreement is contingent upon the modification of the Operating Agreement of the Company to the reasonable satisfaction of Tianji and Sam. The

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[4] New York's Limited Liability Company Law, in §102(r), defines "Membership Interest" as

> a member's aggregate rights in a limited liability company, including, without limitation: (i) the member's right to a share of the profits and losses of the limited liability company; (ii) the member's right to receive distributions from the limited liability company; and (iii) the member's right to vote and participate in the management of the limited liability company.

All three of these statutorily defined rights were conveyed to Li in the Secret Agreement.

> execution of the amended, restated or modified Operating Agreement of the Company [the Second Agreement] by Tianji and Sam shall be considered approval of the said Agreement, and this Agreement will be come immediately effective thereafter.

(Shao Aff., ¶ 9 and Exhibit C, p. 9.)

The Unfolding Of The Scheme

Prior to the machinations of December 2010, earlier that Fall, Li advised Shao that he wanted to dissolve Exceli-Star and distribute its assets to its members. Shao and Li would simply own what had been their joint membership interest in the Company -- through Exceli-Star -- individually (in Li's case, through his own LLC), on a *pro rata*, 50/50 basis. This request was not acted upon immediately, but Li would soon press it again.

On December 8, 2010, Shao met with Chang, Li and their lawyers. At the meeting, Li again asked that Exceli-Star be dissolved and its membership interest in the Company divided up and transferred, respectively, to Li's own LLC, Shao and their 5% partner. Shao agreed -- he saw no reason not to -- and, as a result, ownership of the membership interests in the Company was now as follows: Chang's Company, 50.1%; Shao, 23.7%; Li's Company, 23.7%; and the silent partner, 2.5%. (Shao Aff., ¶ 11.) What Shao did not, and could not, know was that the dissolution of Exceli-Star was merely a tactic by Li and Chang to inveigle Shao into agreeing to a new Second Amended and Restated Operating Agreement for the Company, the Second Agreement, which -- by virtue of Chang and Li's Secret Agreement -- would give Li full control of the Company, remove Shao as a manager and exclude him from having any active role in the Company, a business in which Shao had invested millions of dollars of personal assets and expended substantial time and effort to establish. (Shao Aff., ¶ 12.)

The Second Agreement

The Second Agreement was proposed by Chang at the December 8, 2010 meeting and was prepared by Chang's attorney, Brian Wynn, Esq. The critical change, as Chang explained it, was in the number of management votes. Under the proposed amended version, Li and Shao would each have one vote, but Chang would have two votes. Chang explained that if Li and Shao were in disagreement, Chang would be able to act as the deciding vote, which he would exercise only in the Company's best interests. (Shao Aff., ¶ 13.) Shao agreed to this procedure and executed the Second Agreement. (The Second Agreement is annexed to the Shao Aff. as Exhibit G.)

What was not explained to Shao was that other, seemingly innocuous, almost unrecognizable changes would, as a result of the Secret Agreement between Chang and Li, enable Li to wrest control of the Company. Recognizing that they needed a way around the right of first refusal provision to permit Chang to sell his membership interest to Li, they recast the definition of "Transferability." While the First Agreement prohibited a member from making various forms of transfers of his membership interest, the Second Agreement *omitted* from the list of prohibitions, the words "assign" and "pledge," an omission few readers would notice. Then, new language was inserted explicitly permitting a pledge (but not a sale) of one's membership interest. And since the "Offer to Acquire" and "Right of First Refusal" provisions continued to apply only to a "sale," if a member wanted to "assign" or "pledge" his interest, he could presumably do so without having to comply with the right of first refusal procedure. (Shao Aff., ¶ 14 and Exhibit G.) The new version of the "Transferability" provision reads as follows:

> **GENERAL**. Except as set forth in this Agreement, no Member shall gift, sell, exchange or otherwise transfer to another person any portion of a Membership Interest. Nothing contained herein shall be deemed to prohibit a Member from pledging his Membership Interest. Any Member may freely

> transfer is or its membership interest or a portion thereof to a close family member (related by blood or marriage) or into a trust for the benefit of a Member provided that an original of any such assignment of Membership Interest be provided to the other Members. Any Membership transfer permitted by this section shall not be subject to any Right of First Refusal as provided below. Ther term of "close family member" shall mean spouses, children, mother of children, siblings, or children of siblings of Members.

(Shao Aff., Exhibit G, p. 13 (emphasis added).)

A second critical, and subtle, change in the Second Agreement from the First Agreement was the reduction from 75% to 73% of the percentage of membership interests in the Company needed to accomplish various significant acts: admission of a member; the disposition of substantially all of the Company's assets; changing the number of managers; electing managers; removing managers; filling a vacancy in the number of managers; approving compensation for a member; constituting a quorum for a meeting of members; and a vote by members. (Shao Aff., ¶ 4 and Exhibit A, pp. 4, 5, 6, and 8.)

Why this seemingly slight change? As we have seen, as soon as Shao was induced to execute the Second Agreement, the Secret Agreement between Chang and Li became effective. And under the Secret Agreement, Chang's 50.1% membership interest in the Company belonged to Li. Coupled with Li's 23.7%, Li now controlled 73.8% of the Company's membership interests. And with Chang's two manager votes, plus his own vote, Li now had three of the four manager votes. In short, unbeknownst to Shao, who, of course, never received the notice that was required under the contract's right of first refusal mechanism, Li now was in the driver's seat: he had complete control of the Company. Ownership of the Company as a result of the Second Agreement, in combination with the Secret Agreement, is illustrated in the chart annexed to the Shao Aff. as Exhibit H.

Li Strips Shao Of All Managerial Authority

Li and Chang concealed their Secret Agreement and the transfer to Li of all of Chang's rights in the Company for months -- until after Shao was able to obtain a temporary Certificate of Occupancy for the building and the New World Mall officially opened in May 2011. During that period alone, between December 2010 and May 2011, Shao invested more than $1 million in the project. (Shao Aff., ¶ 18.) As soon as the Mall was open for business, Li wasted no time: He revoked Shao's manager status, barred him from participation in management of the Company, froze the payroll account, denied Shao access to the Company's bank accounts, opened a new "management office" and sent notices to all subtenants informing them that Shao had been removed as a manager and had no authority to act on behalf of the Company and no legal right to sign documents as a representative of the Company. Li also withdrew $300,000 from the Company's bank account and refused to return it and blocked Shao from access to any of the Company's accounts. And shortly thereafter Li took legal action to terminate the subleases -- the Company's only asset and its only source of cash flow. Not surprisingly, as a result, the Company is now involved in considerable litigation with the subtenants. (Shao Aff., ¶¶ 19-20.)

On the evening of May 25, 2011, Shao and his wife went to Chang's home to confront him. Chang acknowledged that he had transferred his interest to Li for the same amount Chang had invested in the Company, plus an additional $50,000 per month. Chang explained that he was in financial difficulty and needed the money. (Shao Aff., ¶ 21.)

ARGUMENT

CHANG'S "ASSIGNMENT" OF HIS MEMBERSHIP INTEREST TO LI IN THE SECRET AGREEMENT WAS EFFECTIVELY A SALE, AND THEREFORE A BREACH OF THE SECOND AGREEMENT

In the Secret Agreement, Chang "irrevocably assign[s]" to Li and Li accepts "any and all of the rights, and benefits resulting from or associated with" Chang's entire 50.1% membership interest in the Company. Along with the "assignment," Chang gave Li an irrevocable proxy, a power of attorney and an irrevocable appointment as a manager of the Company.

To mask the fact that Chang was effectively selling his membership interest to Li (and thereby circumventing the contractually required notice to Shao and right of first refusal), Chang and Li dressed up their Secret Agreement with the elements of an "assignment," which, though prohibited under the First Agreement, would be permitted under the soon-to-be-executed Second Agreement. However, these provisions were nothing more than a device to enable Chang and Li to disguise the effective sale of Chang's membership interest in the Company to Li.

By their deletion of the restriction on an "assignment" in the Second Agreement, coupled with their retention of the prohibition against a "sale," the parties authorized an assignment for the limited purpose of "security." The Second Agreement expressly added the right to "pledge" their membership interests, which implemented the right to assign them for security.

An assignment of rights as security secures an obligation from the assignor to the assignee. For example, suppose a person borrows money and gives the lender a mortgage, which the mortgagee then "assigns" to another party. As the First Department has noted, "Under New York law, an assignment of a mortgage as collateral security results in a pledge, not a sale, of the bond and mortgage." Desser v. Schatz, 182 A.D.2d 478, 480, 581 N.Y.S.2d 796, 797 (1st Dep't 1992). When the obligation is discharged, the contractual rights assigned or the property pledged

return to the assignor. Here, however, the rights that Chang transferred to Li along with his membership interest were, by the terms of their own agreement, *irrevocable*. The so-called "Security Agreement" purported to give Li a security interest in the "collateral," described as Chang's membership interest in the Company. But what was being "secured" by this collateral? Purportedly, Chang's "obligations" to Li. (See Secret Agreement, §2.5, which states: "[Chang] hereby grants to [Li] a security Interests [sic] in all of the right title and Interests [sic] of NWM [Chang's LLC] in and to the collateral to secure the full and prompt payment and performance of all of NWM's and [Chang's] obligations under this Agreement." Exhibit C, p. 4.) And what "obligations" did Chang have to Li? None, other than the illusory obligations of not transferring or encumbering the collateral that he, in fact, was selling -- a circular proposition. There was no underlying substantive obligation that was being collateralized. Therefore, the transaction was effectively a "sale," not an assignment for security

As is apparent from the very terms of the Secret Agreement, the Chang-Li assignment was an unqualified, general assignment rather than an assignment of collateral for security, in that it transferred all the right title and interest Chang had in his membership interest to Li, and Chang had no remaining power over or interest in the subject of the assignment. And a general assignment is the equivalent of a sale. Iavarone v. Lefcon Partnership, No. 18687/90, 1991 WL 11763899, at *1 (Sup. Ct. Nassau Co. July 8, 1991) (holding that assignors forfeit all interest in and all control over the subject of a general assignment, having effectively "sold their interest in the contract.").

Although Defendants described their transaction in the Secret Agreement as an "assignment," they were attempting to construct a pledge, a form of transfer explicitly permitted by the Second Agreement. However, the Chang-Li secret transaction, in its entirety, was

completely inconsistent with the elements of a pledge. As a matter of law, this transaction was in substance a sale, a prohibited form of transfer under the Second Agreement.

A pledge is a bailment of goods to a creditor as security for some debt or engagement or the performance of an act. See Black's Law Dictionary, 5th ed. In other words, the pledgor owes some obligation to the pledgee for which the property or right pledged is security. The pledge is terminated if and when the obligation is discharged. By contrast, the Chang-Li transaction, as set forth in the Secret Agreement, has all of the indicia of a sale, in which both possession and ownership of property are permanently transferred to the buyer. Chang incurred no obligation to Li for which the pledge was security. To the contrary, Chang was to be paid handsomely each month for having made the "pledge."

Although Chang and Li attempted to disguise the sale to Li of Chang's membership interest in the Company by adding some of the characteristics of a secured transaction, the transfer was really a sale, as reflected in Li's receipt of an irrevocable proxy to vote, his irrevocable managerial appointment, his power of attorney, the fact that the "Term" of his agreement with Chang would last another 17 years and possibly in perpetuity, and the fact that no actual obligation of Chang to Li was secured. This Court should ignore the Secret Agreement's attempts at subterfuge and treat the Chang-Li transaction for what it was -- a sale by Chang to Li of his membership interest in the Company for which Li paid Chang $1,520,000 and continues to pay Chang an additional $50,000 each month.[5]

[5] As noted above in our Preliminary Statement, plaintiff challenges (but not on this summary judgment motion) the validity of the Second Agreement, which defendants have breached. The acts challenged on this motion would be equally violative of the First Agreement, should the Court ultimately determine it to be the operative agreement among the parties.

CONCLUSION

For the reasons set forth above and in the accompanying affidavit of Michael Shao, plaintiff's motion for partial summary judgment should be granted declaring that defendants breached the Second Agreement, and that the acts taken by defendants pursuant to and under the Secret Agreement, including the purported assignment by Chang to Li of his member interest, the Manager Authorization Agreement, Irrevocable Proxy and Power of Attorney, all dated December 8, 2010, as described in the Shao Affidavit, be declared invalid.

Dated: New York, New York
April 26, 2012

Respectfully submitted,

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