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

----------X Index No. 651498/2015

KEVIN P. GALLAGHER,

Plaintiff, Hon. David B. Cohen
Motion Sequence #5

-against-

JOHN CROTTY, JOHN WARREN, and JOHN FITZGERALD,

Defendants.

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

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DelBello Donnellan Weingarten Wise & Wiederkehr, LLP
One North Lexington Avenue, 11th Floor
White Plains, New York 10601
Phone: (914) 681-0200
Facsimile: (914) 684-0288

*Attorneys for Plaintiff Kevin P. Gallagher*

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Plaintiff Kevin P. Gallagher ("Plaintiff" or "Gallagher") submits, by his attorneys DelBello Donnellan Weingarten Wise & Wiederkehr LLP, this Memorandum of Law together with the accompanying Affirmation of Peter. S. Dawson and the exhibits thereto, and the accompanying Affidavit of Kevin P. Gallagher and the exhibits thereto, in support of his motion for partial summary judgment on his Third Cause of Action in the Amended and Supplemental Complaint (the "Amended and Supplemental Complaint," **NYSCEF Doc. No. 192**, **Dawson Aff. Exhibit 1**)[1].

## PRELIMINARY STATEMENT

This case involves the Defendants' misconduct in freezing Plaintiff out of the business known as Workforce Housing Advisors ("WFHA"). WFHA purchases over-leveraged loans on multi-family real estate properties in New York City, or purchases those properties outright, and rehabilitates the properties to function as affordable workforce housing in partnership with private investors and government agencies. WFHA's business model relies on low-cost government financing and/or tax credits to facilitate its real estate investments in New York City, and utilizes various limited liability companies to operate the businesses and affiliates of WFHA that manage its properties and orchestrate their redevelopment.

The Amended and Supplemental Complaint asserts causes of action for accounting of the partners of the WFHA partnership, attorneys' fees associated with Plaintiff's efforts to enforce certain rights under the operating agreements for WFHA's various limited liability companies in accordance with the provisions of those operating agreements, breach of contract, breach of fiduciary duty and an accounting of various entities that were operated by the WFHA partnership (see, **NYSCEF Doc. No. 192**, **Exhibit 1**).

[1] References to exhibits in this Memorandum of Law shall refer to exhibits to the Dawson Affirmation unless specifically identified to be exhibits to the Affidavit of Kevin Gallagher (*ie*., Gallagher Aff. Ex. X).

Although this case presents complicated issues concerning the parties' agreements and conduct with respect to WFHA and its complex business model, there are no issues of fact to try with respect to Plaintiff's claim for breach of contract as it concerns certain operating agreement amendments entered into by the Defendants without Gallagher's consent. Thus, this motion is limited to one simple, discrete issue - the enforcement of provisions in certain WFHA operating agreements that prohibit their amendment without unanimous or super majority consent where the amendment would adversely affect any member or "alter the manner of computing the Distributions of any Member." Plaintiff should be awarded partial summary judgment on this issue because:

*First*, it is undisputed that Plaintiff and Defendants are members of WFHA Workforce Housing Advisors MM, LLC ("MMI"); (2) Workforce Housing Advisors MMII, LLC ("MMII"); and (3) WFHA Kelly Managers, LLC ("Kelly Managers).

*Second*, there is no dispute that the Defendants amended the operating agreements for Kelly Managers, MMI, and MMII, without Plaintiff's consent, and to his detriment. The amendments were effectuated by Crotty, Warren and Fitzgerald in 2017 to establish a $1,000.00 per unit priority "management fee" that Defendants admit was designed to divert monies away from Gallagher, and to Crotty, Warren, and Fitzgerald. This priority "management fee" supplies Defendants with an income stream from these WFHA entities without having to pay Gallagher a corresponding distribution, resulting in a dilution of Gallagher's interests.

*Third*, the amendments are prohibited as a matter of law by the express terms of the operating agreements, which require unanimous or super majority consent for amendments that would (a) "adversely affect any member in any material respect"; or (b) alter "the manner of computing the Distributions of any Member."

*Fourth*, Gallagher did not consent to the amendments. And,

*Fifth*, Defendants admitted at depositions that they considered the adverse effect of the amendments at issue on Plaintiff, and specifically considered and understood the adverse effect on his distributions, and effectuated the amendments anyway.

Accordingly, Gallagher should be awarded partial summary judgment on the breach of contract claim in his Third Cause of Action (i) determining that the Defendants' breached the Operating Agreements for MMI, MMII and Kelly Managers by impermissibly amending them without the required consents; (ii) declaring the amendments void, and (iii) directing that the Defendants provide an accounting to Plaintiff of all management fees paid pursuant to the amendments; or alternatively, scheduling an inquest at the conclusion of this case to determine the damage to Plaintiff resulting from the amendments.

## BACKGROUND

### A. Gallagher is Frozen out of WFHA

Gallagher co-founded WFHA in 2008 with Defendant John Crotty ("Crotty") (Gallagher Aff. ¶2), and in doing so contributed his own personal capital to launch the company (*Id*. ¶4). Defendant John Warren ("Warren") joined WFHA as a partner in June 2009 (*Id*. at ¶2). Defendant John Fitzgerald ("Fitzgerald"), who had been a core investor in WFHA's early projects, joined Gallagher, Crotty, and Warren as an equal partner in 2011 (*Id*.). In 2013 and 2014, the Defendants froze Gallagher out of WFHA's day to day operations while continuing to utilize WFHA's novel business platform and excluding him from new opportunities that flowed from the track record that WFHA had established (*Id*. at ¶5).

**B. Gallagher Brings this Lawsuit**

Gallagher commenced this action on May 4, 2015. His original Complaint (**NYSCEF Doc. No. 2**) asserted claims for accounting of the partners of the WFHA partnership, breach of contract, breach of fiduciary, and an accounting of the various entities that were operated by the WFHA partnership. Defendants Crotty, Warren and Fitzgerald (together, the "Defendants") filed and served an Answer with Affirmative Defenses and Counterclaims on July 1, 2015 (**NYSCEF Doc. No. 8**). On June 17, 2020, Plaintiff moved by Order to Show Cause (**NYSCEF Doc. No. 183**) to amend his Complaint to assert a new claim for attorneys' fees against the Defendants pursuant to their contractual terms, and to expand his existing breach of contract claim to encompass his claims addressed to the impermissible amendment of the Kelly Managers, MMI, and MMII operating agreements. At a hearing held on October 27, 2020, Judge Masley granted Plaintiff's motion for leave to amend the Complaint, (see Transcript at **NYSCEF Doc. No. 194**). Plaintiff filed his Amended and Supplemental Complaint on October 28, 2020 in accordance with Judge Masley's directions (**NYSCEF Doc. No. 192**, **Dawson Aff. Exhibit 1),** and Defendants filed their Answer on November 12, 2020 **(NYSCEF Doc. No. 195, Exhibit 2).**

In addition to accounting claims addressed to the WFHA partnership (**Exhibit 1** at ¶¶72-78) and the various entities that were operated by the partnership (**Exhibit 1** at ¶¶106-110), the Amended and Supplemental Complaint alleges that Gallagher was wrongfully excluded from WFHA's business opportunities involving distressed multi-family housing funds for the redevelopment of low-income housing in New York City. Gallagher and the Defendants had negotiated a term sheet for the distressed multi-family housing funds with National Equity Fund ("NEF") and Morgan Stanley using the WFHA business model that Mr. Gallagher was instrumental in building, and the Defendants then took these opportunities for themselves, in

breach of fiduciary and contractual duties to Gallagher, through a new entity that they formed in September of 2013 called J Cubed Residential, LLC ("J Cubed") (**Exhibit 1** ¶¶48-56, 92, 100-105). The Amended and Supplemental Complaint contains a cause of action for attorneys' fees associated with Gallagher's efforts to enforce his rights under the parties' agreements (**Exhibit 1** ¶¶79-85), and also includes breach of contract claims addressed to the impermissible amendment of certain operating agreements (**Exhibit 1** ¶¶68-71, 88), and to Crotty's misappropriation of more than $650,000 that Gallagher loaned to him in the form of revenue remittances from a company known as Xavier Property Management LLC ("Xavier")[2] (**Exhibit 1** ¶¶36-39).

This motion concerns only Gallagher's claim in the Amended and Supplemental Complaint that Defendants breached the operating agreements for Kelly Managers, MMI, and MMII by amending them to their benefit and Gallagher's detriment, without his consent.

**C. Defendants Impermissibly Amend the Operating Agreements for Kelly Managers, MMI, and MMII**

The Defendants adopted resolutions to amend the Operating Agreements for MMI, MMII, and Kelly Managers to benefit themselves, at the expense of Gallagher, in July 2017 and October 2017 (Gallagher Aff. ¶¶13-17). The amendments (**Gallagher Aff. Exhibits 10-12, 15-17**), enacted during the pendency of this action, after Defendants froze Gallagher out of WFHA and the day-to-day participation in its projects, provide for a priority $1,000 a door "Management Fee" to be paid to the WFHA members (namely, Defendants) that are involved in the day-to-day management of its projects.

The Operating Agreements for MMI and for MMII state in pertinent part:

[2] Xavier had been formed by Gallagher, Crotty and Warren to enter into a consulting agreement with WinnResidential (NY) LLC ("Winn") pursuant to which Winn paid Xaver percentages of revenues from property management opportunities generated by WFHA. Crotty did not remit Gallagher his share of those revenues (Gallagher Aff. ¶5). The Xavier claim is not before the Court on this motion.

Section 19.1 Amendment.

(a) The terms and provisions this Agreement may be modified or amended at any time and from time to time by Majority Consent, to … …(iii) make a change that is necessary or desirable to cure any ambiguity, to correct or supplement any provision in this Agreement that would be inconsistent with any other provision in this Agreement, or to make a change to any other provision with respect to matters or questions arising under this Agreement that will not be inconsistent with the provisions of this Agreement, in each case **so long as such change** does not increase the financial obligations of the Members and **does not otherwise adversely affect the Members in any material respect**…

**(b)** Notwithstanding the foregoing, none of the following amendments shall be made with respect to any Member if the effect on such Member is disproportionate to such Member as compared to the effect on all other Members without such Member's consent: (i) any amendment to this Agreement that requires such Member to make a Capital Contribution or loan to the Company not required as of the date hereof; (ii) any amendment to the provisions of Article XVIII that cause such provisions to be materially less favorable to such Member than prior to the amendment; (iii) any amendment to Section 6.8; (iv) except as otherwise provided in this Agreement, any amendment to Section 13.1 or this Section 19.1; (v) except as otherwise provided in clause (a) of this Section 19.1 or otherwise in this Agreement, any amendment to this Agreement which alters the allocation for tax purposes of income, Net Profits, Net Losses, deductions, or credits; or (vi) **any amendment to this Agreement which alters the manner of computing the Distributions of any Member.**

(**Gallagher Aff. Exhibits 7 and 8 at §19.1**) (**emphasis added**). The Operating Agreement for Kelly Managers is similar but instead of requiring unanimous consent for changes that adversely affect members, it provides for super majority consent for such changes states in pertinent part:

Section 19.1 Amendment.

(a) The terms and provisions of this Agreement may be modified or amended at any time and from time to time with the written consent of Members owing in excess of 90% of the Proportionate Shares; provided, however, that the Members may, by Majority Consent, amend this Agreement without the vote or written consent of the Members to… …(iii) make a change that is necessary or desirable to cure any ambiguity, to correct or supplement any provision in this Agreement that would be inconsistent with any other provision in this Agreement, or to make a change to any other provision with respect to matters or questions arising under this Agreement that will not be inconsistent with the provisions of this Agreement, in each case **so long as such change** does not increase the financial

> obligations of the Members and **does not otherwise adversely affect the Members in any material respect**…
>
> **(b)** Notwithstanding the foregoing, none of the following amendments shall be made with respect to any Member if the effect on such Member is disproportionate to such Member as compared to the effect on all other Members without such Member's consent: (i) any amendment to this Agreement that requires such Member to make a Capital Contribution or loan to the Company not required as of the date hereof; (ii) any amendment to the provisions of Article XVIII that cause such provisions to be materially less favorable to such Member than prior to the amendment; (iii) any amendment to Section 6.8; (iv) except as otherwise provided in this Agreement, any amendment to Section 13.1 or this Section 19.1; (v) except as otherwise provided in clause (a) of this Section 19.1 or otherwise in this Agreement, any amendment to this Agreement which alters the allocation for tax purposes of income, Net Profits, Net Losses, deductions, or credits; or (**vi) any amendment to this Agreement which alters the manner of computing the Distributions of any Member.**

(**Gallagher Aff. Ex. 9**). (**emphasis added**).

Gallagher did not consent to any of the amendments. (**Gallagher Aff. ¶10**). They were enacted over his objections (**see, Gallagher Aff. ¶10 and Exhibits 13 and 14**).

The priority "management fees" created by the amendments benefit Defendants by allowing them to pay themselves without paying Gallagher, which depletes the profits available to pay distributions to Gallagher (**Gallagher Aff. ¶10**). The five properties affected by the Defendants' wrongful amendments are comprised of a total of 463 units, meaning that the $1,000 per unit priority fee redirects $463,000 a year to the Defendants (***Id***.). As a result, Gallagher does not get to share in the profits of the companies, and the corresponding dilution renders his interests worthless (***Id***.).

Mr. Fitzgerald confirmed that the management fee would benefit the Defendants at Gallagher's expense:

> Q. How does this impact Mr. Gallagher's distributions in MM-II? Because now you - - a management fee is paid to Mr. Crotty, Mr. Warren, and Mr. Fitzgerald pursuant to this resolution before anybody gets distributions, correct?

A. Seems that way. They're entitled to be paid, right?

(*Id*. at p. 171 at lines 13-19.)[3] Mr. Warren, whose signature enacted the amendments (Gallagher Aff. Exhibits 15-17), explained the amendments at his deposition and their effect on Kevin Gallagher:

Q. How does the resolution affect distributions and fees to be paid to Kevin Gallagher?

A. If there are fees due to the managing member, it would be apportioned to the - - to this fee before any distributions are made from the managing member's share of distributions.

Q. So, in effect, it would be a reduction to the distributions and fees to Kevin Gallagher by creating a priority of management fees above his; is that correct?

A. On the managing member's side, yes.

(**Exhibit 5**, Tr. J. Warren, August 19, 2020 at p. 243 lines 24-25 – p. 244 lines 1-11). He was even more blunt a short time later:

Q. Did you consider the effect to Kevin Gallagher prior to passing this resolution?

A. Yes.

Q. What did you consider?

A. We considered that it would have an economic impact on Mr. Gallagher.

Q. What kind of impact would it have?

A. In theory, it would diminish distributions to Mr. Gallagher.

Q. At the time you were in litigation with Mr. Gallagher, correct?

A. Yes.

[3] The Defendants' deposition transcripts were sent to Defendants' counsel for review and signature on October 29, 2020 (see Dawson Aff. ¶¶10-11, Notice to Return Transcript, Fitzgerald, Exhibit 5, and Notice to Return Transcript, Warren, Exhibit 6. They were never signed and returned (Dawson Aff. ¶12). The transcripts may be used on this motion as though signed. NEW YORK CPLR 3116(a).

(*Id.* at p. 265, lines 24-25 – p. 266, lines 11). Warren confirmed that he is receiving management fees pursuant to the amendments (*Id*. at p. 266 line 22-24). Gallagher has not (Gallagher Aff. ¶10).

## LEGAL ARGUMENT

### Standard

Summary judgment is properly granted where the moving party makes "a *prima facie* showing of entitlement to judgment as a matter of law, tendering sufficient evidence to demonstrate the absence of any material issues of fact." *Alvarez v. Prospect Hosp.*, 68 N.Y.2d 320, 324 (1986); *see Pullman v. Silverman*, 28 N.Y.3d 1060, 1062 (2016). Once that showing has been made, "the burden shifts to the party opposing the motion for summary judgment to produce evidentiary proof in admissible form sufficient to establish the existence of material issues of fact which require a trial of the action." *Alvarez v. Prospect Hosp*., 68 N.Y.2d at 324. The opposing party "must lay bare its proof and present evidentiary facts sufficient to raise a genuine triable issue of fact." *Morgan v. New York Tel*., 220 A.D.2d 728, 729 (2d Dep't 1995); *see Zuckerman v. City of New York*, 49 N.Y.2d 557, 562 (1980). "[M]ere conclusions, expressions of hope or unsubstantiated allegations or assertions are insufficient" to withstand summary judgment. *Zuckerman v. City of New York*, 49 N.Y.2d at 562.

### POINT ONE

### GALLAGHER IS ENTITLED TO SUMMARY JUDGMENT ON HIS CLAIM FOR BREACH OF CONTRACT ARISING FROM DEFENDANTS' IMPERMISSIBLE AMENDMENT OF OPERATING AGREEMENTS IN BREACH OF THOSE AGREEMENTS

Under New York law, where, as here, "parties set down their agreement in a clear, complete document, their writing should, as a rule, be enforced according to its terms." *Spivak v.*

*Bertrand*, 147 A.D.3d 650, 651 (1d Dept. 2017) citing *Ashwood Capital, Inc. v. OTG Mgt., Inc.*, 99 A.D.3d 1, 7 (1d Dept. 2012). The interpretation of an unambiguous contract is a question of law for the court. *Kass v. Kass*, 91 N.Y.2d 554, 566 (1998). A contract is unambiguous if, on its face, it is reasonably susceptible to only one meaning. *Costello v. Molloy*, 73 Misc. 3d 1206(A) (Westchester Cnty, 2021) citing, *Greenfield v. Philles Records, Inc.*, 98 N.Y.2d 562, 570 (2002).

There are no ambiguities here. The Operating Agreements for MMI, MMII, and Kelley Managers plainly prohibit the amendments that were enacted by the Defendants to benefit themselves. Those Agreements expressly state that they cannot be changed by majority consent to adversely affect the Members in any material respect **(Gallagher Aff. Exhibits 7, 8, and 9 at §19.1[a][iii]),** or, [alter] the manner of computing the Distributions of any Member **(*Id.* at §19.1[b][vi]).** The changes made by the Defendants would require unanimous consent under the terms of the MMI and MMII Operating Agreements, and super-majority consent under the terms of the Kelly Managers' Operating Agreement. Defendants amended the operating agreements to establish priority fees that would be paid to them. These fees were specifically calculated to divert funds to the Defendants at the expense of Gallagher. The result is that Gallagher's interests are diluted and devalued, while Defendants live off of the profits they pay themselves from WFHA's businesses.

There can be no question that these amendments "adversely affected" Gallagher. Defendant Fitzgerald admitted that they were enacted because "the Johns really had it" with Gallagher (**Exhibit 4, Tr. J. Fitzgerald, July 21, 2020 at p. 168 line 9**), and that they impacted his distributions:

> Q. How does this impact Mr. Gallagher's distributions in MM-II? Because now you - - a management fee is paid to Mr. Crotty, Mr. Warren, and Mr. Fitzgerald pursuant to this resolution before anybody gets distributions, correct?

A. Seems that way. They're entitled to be paid, right?

(***Id*. at p. 171 at lines 13-19**) Defendant Warren testified that the Defendants specifically considered the fact that the amendments "would diminish distributions to Mr. Gallagher" **(Exhibit 5, Tr. J. Warren, August 19, 2020 at p. 265-266)**, and that there would be a reduction to Gallagher's distributions by establishing the $1,000 a door fee:

> Q. So, in effect, it would be a reduction to the distributions and fees to Kevin Gallagher by creating a priority of management fees above his; is that correct?
>
> A. On the managing member's side, yes.

(**Exhibit 5**, Tr. J. Warren, August 19, 2020 at p. 243 lines 24-25 – p. 244 lines 1-11). The Defendants understood that the amendments would have that effect:

> Q. Did you consider the effect to Kevin Gallagher prior to passing this resolution?
>
> A. Yes.
>
> Q. What did you consider?
>
> A. We considered that it would have an economic impact on Mr. Gallagher.
>
> Q. What kind of impact would it have?
>
> A. In theory, it would diminish distributions to Mr. Gallagher.

(*Id.* at p. 265, lines 24-25 – p. 266, lines 11). These admissions conclusively demonstrate the Defendants' breach of §19.1(a)(iii) of the MMI, MMII and Kelly Managers Operating Agreements by intentionally enacting provisions that adversely affected Gallagher without his consent. Similarly, the admissions demonstrate that Defendants breached §19.1(b)(vi) of the same agreements by altering "the manner of computing the Distributions of any Member"

without Gallagher's consent. (**See, Gallagher Aff. Exhibits 7, 8, and 9 at §19.1[a][iii] and [b][vi[).**

Significantly, the amendments and the corresponding actions taken in writing by the Defendants in lieu of a meeting result in the payment of management fees "when the Company makes a distribution in accordance with its Operating Agreement." (**See, Gallagher Aff. Exhibits 10, 11 and 12 at Action in Writing By the Members in Lieu of Meeting, p. 1**.) The amendment is written in such a way that the Defendants are entitled to the full value of the management fee independent of and prior to calculating the profit share due to the members. This allows the Defendants to jump in front of Plaintiff's distributions when allocating profits out to the members, directly diminishing the distributions allocated to him and increasing the monies paid to the Defendants, in direct violation of the Operating Agreements which expressly require unanimous or super-majority consent for amendments that would reallocate the manner of computing the distributions to the Members. (**See, Gallagher Aff. Exhibits 7, 8, and 9 at §19.1[a][iii] and [b][vi[.)**

The case of *Overhoff v. Scarp, Inc*., 12 Misc. 3d 350 (Erie Cnty 2005) is directly on point. There, the Court considered the effect of certain actions taken by the majority of members of an LLC, where the operating agreement for that LLC specifically required unanimous consent. *Overhoff v. Scarp, Inc*., 12 Misc. 3d 350, 362. The Court noted that the Operating Agreement at issue contained "safeguards against oppression of minorities" in the form of a section which addressed "*Actions Requiring Approval of All Members*". *Id*. Since the actions taken by the majority members in *Overhoff* involved the transfer of an interest in LLC property, which was an action that required the approval of all of the members, the Court determined that they were "null, void and of no effect." *Id*.

Here, just as in *Overhoff*, the Defendants' amendments were made without the required unanimous, or in the case of Kelly Managers, super-majority consents. Accordingly, just as in *Overhoff*, the amendments should be declared null void, and Defendants should be directed to provide an accounting to Plaintiff of all fees paid pursuant to the impermissibly amended Operating Agreements. In the alternative, an inquest should be held to determine the extent of the damage to Gallagher once Plaintiff has all information from Defendants that is necessary to evaluate his damage.

## CONCLUSION

For all of the foregoing reasons, it is respectfully requested that the Court grant Plaintiff's motion for partially summary judgment together with such other and further relief as the Court may deem just and proper.

Dated: White Plains, New York
March 15, 2022

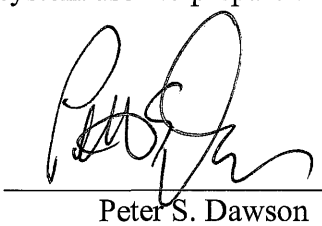
DelBello Donnellan Weingarten
Wise & Wiederkehr, LLP

By: _____
Peter S. Dawson, Esq.
Alfred E. Donnellan, Esq.
Brian J. Donnellan, Esq.
One North Lexington Avenue, 11th Floor
White Plains, New York 10601
Phone: (914) 681-0200
*Attorneys for Plaintiff Kevin P. Gallagher*

**CERTIFICATION PURSUANT TO COMMERCIAL DIVISION RULE 17**

I, PETER S. DAWSON, ESQ., an attorney at law licensed to practice in the State of New York, and counsel of record herein, certify that this document contains 3,834 words, exclusive of the caption page, table of contents and table of authorities and signature block, as counted by the word count of the word-processing system used to prepare this document.

Dated: White Plains, New York
March 15, 2022



Peter S. Dawson