

SUPREME COURT OF THE STATE OF NEW YORK  
COUNTY OF NEW YORK: PART 60

In the Matter of the Application of

LAWRENCE A. CLINE, as a Member of Private Capital Management, LLC, and PCM INTEREST HOLDING, LLC, as a Beneficial Holder of Part of the Economic Interest in Private Capital Management, LLC,

*Petitioners,*

for an order and judgment dissolving the limited liability company, Private Capital Management, LLC, pursuant to New York Limited Liability Company Law Section 702,

*-against-*

THOMAS B. DONOVAN,

*Respondent.*

**Index No. 650117/09  
(Fried, J.)**

**AFFIRMATION OF DAVID J.  
KATZ IN SUPPORT OF  
RESPONDENT'S MOTION TO  
DISMISS VERIFIED PETITION**

**Mot. Seq. No. 2**

**DAVID J. KATZ**, an attorney duly admitted to the Bar of the courts of this state, affirms under penalty of perjury, the following to be true:

1. I am an attorney employed by Schlam Stone & Dolan LLP, counsel to Respondent Thomas B. Donovan, in the above-captioned special proceeding. I submit this affirmation in support of Respondent's motion, brought on by order to show cause, for an Order pursuant to CPLR §§ 404 and 406(a), dismissing the Verified Petition with prejudice for failure to state a claim upon which relief can be granted. Unless otherwise stated, I make this affirmation based upon my personal knowledge or upon review of my files.

**PRELIMINARY STATEMENT**

2. This special proceeding is the latest chapter in Petitioners' coordinated litigation strategy against Mr. Donovan. Earlier chapters have included: (a) an unsuccessful and belated motion by Petitioner Lawrence Cline to disqualify Edward J. Nitkewicz, counsel to Private

Capital Management, LLC (“PCM”) in the “main” Ficus action (Index No. 600926/2007), which this Court concluded was made in bad faith; (b) an unsuccessful attempt to oppose a motion made by Mr. Nitkewicz on behalf of PCM in the “main” Ficus action to compel Private Capital Group, LLC (“PCG (FL)”) to live up to its contractual obligations to advance PCM’s litigation fees and disbursements, even after this Court had already granted the same relief to Mr. Donovan based on the same provisions in PCG (FL)’s operating agreement; and (c) an unsuccessful attempt by Plaintiffs and Cline in the “main” Ficus action to dissolve PCM via a cross-motion to PCM’s advances motion, which this Court held could not be accomplished other than by commencing a plenary proceeding and which Ficus’ counsel admitted was being made to cut off PCM’s right to advances of its litigation fees from PCG (FL).

3. It is against this backdrop that Petitioners have commenced this special proceeding in an attempt to dissolve PCM. For the reasons discussed below, the Verified Petition should be dismissed with prejudice for failing to state a claim upon which relief can be granted. Specifically: (a) Petitioner PCM Interest Holding, LLC (“PCMIH”) should be dismissed as a Petitioner because, by its own admission, it is not a member of PCM and thus lacks statutory standing to seek dissolution of PCM; and (b) the Verified Petition should be dismissed because the law is clear that an alleged deadlock between a limited liability company’s two managing members cannot provide a basis for dissolution where the sole purpose of the LLC is admitted to being a passive investor in another entity.

#### **FACTS ALLEGED IN VERIFIED PETITION**

4. The facts alleged in the Verified Petition (a copy of which is attached hereto as Exhibit A) are fairly straightforward and are assumed to be true for the purposes of this motion.<sup>1</sup>

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<sup>1</sup> Donovan’s acceptance of the facts alleged in the Verified Petition in the context of this motion should not be construed as an admission by him that any of these allegations are true. Many are not. Indeed, as discussed below,

Cline is alleged to be a managing member of PCM and the former President of PCM who holds 50% of the membership interest in PCM, and PCMIH is alleged to be a beneficial holder and assignee of Cline's economic interest in PCM and to be wholly owned by Ficus Investments, Inc ("Ficus"). (Exh. A. ¶¶ 5, 14.) Donovan is alleged to be PCM's other managing member and the holder of the remaining 50% membership interest in PCM. (*Id.* ¶ 6.)

5. PCM is a New York limited liability company that allegedly was formed by Cline and Donovan to hold a 20% membership interest in PCG (FL), a Florida limited liability company. (*Id.* ¶¶ 7-8.) According to Petitioners, "PCM never had any purpose nor any business of its own. Indeed, PCM was never meant to conduct any business (and, in fact, has not) as it was created simply to hold Cline and Donovan's 20% [membership] interest in [PCG (FL)]." (*Id.* ¶ 10.)

6. In March 2007, Ficus and PCG (FL) commenced an action against Donovan (the former CEO of PCG (FL)), Cline (the former President of PCG (FL)), and PCM. (*Id.* ¶ 11.) In July 2007, Cline settled with PCG (FL) and Ficus and agreed to cooperate with PCG (FL) and Ficus in their various litigations against Donovan. (*Id.* ¶ 14.) Donovan has asserted counterclaims and third-party claims against, among others Cline, Ficus, and PCG (FL), on behalf of himself and derivatively on behalf of PCM. (*Id.* ¶ 16.)

7. According to Petitioners, "[a]s a result of Cline and Donovan becoming adverse due to these litigations, the direction and control of PCM is hopelessly deadlocked. In fact, at various times . . . Cline has directed PCM not to take certain actions with respect to the litigation" and "Donovan has used PCM to do the exact opposite." (*Id.* ¶ 17.) Petitioners further allege that "PCM is stalemated with its sole members in direct conflict with one another.

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if this motion is denied, Donovan expressly reserves the right to contest the facts alleged in the Verified Petition and respectfully requests permission to file an Answer in which he will do so.

Consequently, PCM is no longer able to function in accordance with its intended purposes.” (*Id.* ¶ 18) Finally, Petitioners allege that “[a]s PCM was originally created for the purpose of holding the interests of Cline and Donovan in the Company, and as it is plain that Ficus, [PCG (FL)], and PCM are engaged in an intractable dispute and are unable to restore the relationship among them, PCM no longer serves any legitimate purpose.” (*Id.* ¶ 20.) Thus, they allege, “it is clear that PCM is hopelessly deadlocked, and that [PCM] cannot function as intended.” (*Id.* ¶ 23.)

### ARGUMENT

#### A. **PCMIH HAS NO STANDING TO PETITION FOR DISSOLUTION OF PCM**

8. PCMIH has no standing to petition for dissolution of PCM because it is not alleged to be a member of PCM.

9. Section 604(a) of New York’s Limited Liability Company Law provides, in relevant part, that, “[e]xcept as provided in [an LLC’s] operating agreement, an assignee of a membership interest **may not** become a member without the vote or written consent of at least a majority in interest of the members, other than the member who assigned or proposes to assign such membership interest.” (Emphasis added.) Furthermore, Section 603(a)(3) of the Limited Liability Company law provides, in relevant part, that “the only effect of an assignment of a membership interest is to entitle the assignee to receive, to the extent assigned, the distributions and allocations of the profits and losses to which the assignor is entitled.” Significantly, “an assignment of a membership interest **does not** . . . entitle the assignee to . . . exercise any rights or powers of a member.” *Id.* § 602(a)(2) (emphasis added). And one of the rights that can be exercised only by a member of an LLC is to petition a court to dissolve the LLC in which he, she, or it is a member. *Id.* § 702.

10. Here, the Verified Petition plainly alleges that PCMIH is an assignee of Cline's alleged membership interest in PCM and never alleges that a majority in interest of PCM's members other than Cline (*i.e.*, Donovan) agreed to admit PCMIH as a member of PCM. Thus, PCMIH is merely an assignee of one of PCM's purported members and is not a member of PCM. Thus, it has no standing to petition for PCM's dissolution and it must be dismissed as a Petitioner in this special proceeding. *See R&R Capital, LLC v. Buck & Doe Run Valley Farms, LLC*, 2008 WL 3846318, at \*2 (Del. Ch. Ct. Aug. 19, 2008) (dismissing on the pleadings a petition of an entity that was a member of a member of the LLC it sought to dissolve where the Delaware LLC Act permitted such a proceeding to be brought only by either a member or a Manager of an LLC).

**B. THE VERIFIED PETITION MUST BE DISMISSED AS A MATTER OF LAW BECAUSE THE FACTS ALLEGED IN THE VERIFIED PETITION DO NOT ESTABLISH THAT IT IS NO LONGER REASONABLY PRACTICABLE TO CARRY ON PCM'S ALLEGED BUSINESS**

11. Section 702 of New York's Limited Liability Company Law provides, in relevant part, that a court may issue a decree dissolving a limited liability company only "whenever it is not reasonably practicable to carry on the [LLC's] business in conformity with the articles of organization or operating agreement." In their Verified Petition, Petitioners do not cite to or rely on any provisions of PCM's articles of organization or operating agreement in support of their position that it is not reasonably practicable for PCM to carry on its business. Instead, they argue that the stringent criterion for dissolution in Section 702 has been satisfied as a matter of law only because PCM "is unable to function as intended." (Ex. A. ¶ 24.) *See Schindler v. Niche Media Holdings, LLC*, 1 Misc. 3d 713, 716, 772 N.Y.S.2d 781, 784 (Sup. Ct. N.Y. Co. 2003) (construing standard for dissolution in Section 702 as mandating judicial dissolution of an LLC "only where the complaining member can show that the business sought to be dissolved is

unable to function as intended or else that it is failing financially”), *abrogated on other grounds* by *Tzolis v. Wolff*, 10 N.Y.3d 100, 855 N.Y.S.2d 6 (2008). As discussed below, the facts alleged in the Verified Petition fail to establish, as a matter of law, that PCM is unable to function as intended.

12. The Verified Petition repeatedly alleges that PCM “was formed merely for the purpose of holding Cline’s and Donovan’s interests in” PCG (FL). (Ex. A ¶ 25.) In other words, it alleges that the “intended function” of PCM was to serve as a passive investor in PCG (FL) and receive whatever economic benefits that it is entitled to receive pursuant to PCG (FL)’s operating agreement. Nothing alleged in the Verified Petition indicates that the deadlock or enmity between Donovan and Cline or Donovan and Ficus prevents PCM from continuing to serve as a passive investor in PCG (FL).

13. The facts alleged in the Verified Petition are on all fours with a case recently decided by the Delaware Chancery Court where a petition seeking judicial dissolution was dismissed on the pleadings as a matter of law. Specifically, in *Seneca Investments LLC v. Tierney*, 2008 WL 432930 (Del. Ch. Ct. Sept. 23, 2008), the petitioner sought to dissolve an LLC on the ground that it was no longer reasonably practicable to carry out its business. At the time the dissolution petition was filed, the LLC’s only assets were about \$2 million in cash and a minority interest in a privately held company. *Id.* at \*2.

14. The Chancery Court began its analysis by explaining that it is no longer reasonably practicable to carry out an LLC’s business when there is a “deadlock” that “prevent[s] the [LLC] from operating and where the defined purpose of the entity was fulfilled or impossible to carry out.” *Id.* The Chancery Court then concluded that the purpose of the LLC was to do “no more than take or hold title to tangible investments.” *Id.* at \*3. Thus, there was

nothing alleged in the dissolution petition to show that any deadlock was preventing the LLC from carrying out this purpose: “In effect petitioner has done nothing more than allege that [the LLC] is functioning as a passive instrumentality that is holding title to assets, a corporate function that is both lawful and common.” *Id.* Finally, the Chancery Court noted that the LLC had been pursuing counterclaims and third-party claims in litigation against, among others, the petitioner who was seeking its dissolution both before and after the dissolution petition had been filed. But, as the Chancery Court correctly observed, “[p]ursuing legal claims is an acceptable, and common, corporate function,” and could not in and of itself serve as basis for dissolution. *Id.* at \*5.

15. Like the LLC in *Seneca Investments*, PCM is alleged in the Verified Petition to be engaged in the business solely of holding a passive investment in PCG (FL) and participating in litigation. And, as was the case in *Seneca Investments*, any alleged deadlock or enmity between Cline and Donovan, as matter of law, cannot establish that it is not reasonably practicable for PCM to carry on these activities or that PCM cannot function as intended. Thus, as a matter of law, the allegations in the Verified Petition fail to satisfy “the more stringent standard” for dissolution in Section 702, and the Verified Petition must be dismissed with prejudice. *See Horning v. Horning Constr., LLC*, 12 Misc. 3d 402, 413, 816 N.Y.S.2d 877, 885 (Sup. Ct. Monroe Co. 2006).

**C. IN THE EVENT THAT THE COURT DENIED DONOVAN’S MOTION TO DISMISS, THE COURT SHOULD PERMIT HIM TO FILE AN ANSWER DISPUTING THE FACTS IN THE VERIFIED PETITION, ASSERTING AFFIRMATIVE DEFENSES, AND COUNTERCLAIMING AGAINST CLINE**


16. CPLR § 404(a) provides that, if Donovan’s motion to dismiss for failure to state a claim is denied, this Court may permit Donovan to file an Answer to the Verified Petition. In the

event that this motion is denied, Donovan respectfully requests that the Court permit him to file such an Answer so that he can: (a) deny many of the factual allegations contained in the Verified Petition, (b) assert affirmative defenses bases on facts that will no doubt be in dispute (*e.g.*, (i) Cline is not a member of PCM and lacks standing to bring this special proceeding, (ii) PCM is not located within this judicial district and thus this special proceeding cannot be venued here, and (iii) laches), and (c) assert counterclaims against Cline for bringing this special proceeding in bad faith (as the Court found he recently did in connection with his motion to disqualify PCM's counsel) and for breach of fiduciary duty. Even though these issues are not being raised in this motion, Donovan expressly reserves his rights to raise them and any other issues not raised in this motion if and when the Court grants him permission to file an Answer to the Verified Petition.

**CONCLUSION**

17. For the reasons set forth above, the Verified Petition should be dismissed as a matter of law for failing to state claim upon which relief can be granted.

Dated: New York, New York  
March 27, 2009

  
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DAVID J. KATZ