

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

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 ELDAN-TECH, INC., in the right and name : Index No. 651101/10
 of OCELOT PORTFOLIO HOLDINGS, LLC, :

Plaintiff, :

-against- :

OCELOT CAPITAL MANAGEMENT, LLC, :

Defendant, :

-and- :

OCELOT PORTFOLIO HOLDINGS, LLC, :

Nominal Defendant. :

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MEMORANDUM OF LAW IN OPPOSITION TO MOTION TO DISMISS

Plaintiff Eldan-Tech, Inc. ("Eldan"), by its attorneys, Krol & O'Connor, respectfully submits this memorandum of law in opposition to the motion by Ocelot Capital Management, LLC ("Ocelot"), to dismiss this action - pursuant to CPLR §3211(a)(1), (3) & (7) - on the documentary evidence, Affirmation of David Katz, dated August 5, 2010 ("Katz Aff'n"), ¶1, and (in)applicable law. Ocelot's Memorandum of Law, dated August 5, 2010 ("Ocelot Memo"), *passim*.

INTRODUCTION

This Court will, no doubt, recall that on July 15, 2010, in an action entitled Ocelot v. Hershkovitz, Index No. 603092/09, this Court granted summary judgment in favor of Ocelot and against one Isaac Hershkovitz on the promissory note in the amount of \$350,000, executed by Hershkovitz in favor of Ocelot Portfolio Holdings, LLC ("Portfolio"), in connection with the sale by Portfolio of its 100% membership interest in OCG-VI, LLC, to Hershkovitz. Ocelot Memo, pp. 1-2.

Eldan commenced this action, in Portfolio's name and right, to, *inter alia*, impose a constructive trust upon the identifiable proceeds of the note, by now morphed into the judgment, supra, in the hands of Ocelot. Katz Aff'n, Ex. 1 (Verified Complaint). On July 28, 2010, at oral argument before this Court on Eldan's application for a preliminary injunction, this Court, in essence, invited Ocelot to move to dismiss this action. Affidavit of Igor Krol, sworn to August 19, 2010 ("Krol Aff't"), Ex. A (Transcript), p.15 ("Court: The answer is to be filed within 20 days ...or [a] motion to dismiss is made under the statute.") Ocelot's motion to dismiss followed.

ARGUMENT

Ocelot contends, *inter alia*, that Eldan's complaint must be dismissed, in so many words, "for lack of standing," Ocelot Memo, p.4, under CPLR §3211(a)(3). Put differently, Ocelot claims that Eldan, the holder of 80% membership interest in Portfolio, could not, as a matter of law, commence a derivative action in the name and right of Portfolio where, as here, Eldan could cause Portfolio to sue Ocelot, and, in any event, could not commence such action without first making the requisite demand or stating why such demand would have been futile. Ocelot Memo, pp. 4-5.¹

Alas, the New York Court of Appeals did not limit the right to bring a derivative action to members of a limited liability company holding a minority interest therein. See Tzolis v. Wolff, 10 N.Y.3d 100, 855 N.Y.S.2d 6 (2008) ("Members of LLCs may sue derivatively.")

¹ Had Portfolio sued Ocelot individually, Ocelot would have likely demanded that Eldan cause Portfolio to sue Ocelot derivatively.

After all, Eldan brought the action to "redress wrongs suffered by" Portfolio, not by Eldan. Tzolis v. Wolff, *supra*, at 103. Since the right to bring a derivative action is permissive, RCGLV Maspeth LLC v. Maspeth Properties LLC, 26 Misc.3d 1241(A), 2010 WL 1133245 (Sup. Kings 2010) ("The language in Tzolis is permissive..."), Tzolis neither "impose[d] a mandate upon all members to file suits derivatively," *ibid*, nor required them to file suits individually.²

Indeed, a member holding a **minority** interest is required to make the requisite demand - or state why such demand would have been futile - but not a member holding a majority interest, *e.g.*, Eldan. Compare Sacher v. Ivy Asset Management Corp., 27 Misc.3d 1221(A), 2010 WL 1881951 (Sup. Ct. Nassau 2010) ("Where a **minority** shareholder brings a derivative suit on behalf of a corporation, the complaint must set forth with particularity plaintiff's demand upon the board of directors to bring the action, or the reasons that a demand would have been futile [*emphasis supplied*].") with Ocelot Memo, p.4 ("Where a member of a New York LLC brings a derivative action on behalf of the LLC, 'the complaint must set forth with particularity [the member's] demand upon the board of directors [or the Manager of the LLC] to bring the action, or the reasons that a demand would have been futile.'")³

Here, of course, Eldan is not a minority member; Eldan holds 80% of Portfolio and - though a majority member - Eldan has the

² Were this Court to hold - apparently, for the first time - that a **majority** member of a New York LLC may not bring a derivative action, Eldan would promptly seek leave to file an amended pleading.

³ Every **minority** member is required to make such demand to relieve the courts from "second-guess[ing] the business judgment of the individuals charged with managing the company." Sacher, p.10.

right to bring a derivative action on behalf of Portfolio. Tzolis, supra. As a majority member, Eldan was not required to make a demand upon a board of directors. Sacher, supra. Even if a demand were required - it is not - the courts of New York would likely hold that any demand upon Ocelot would have been futile. Evans v. Perl, 19 Misc.3d 1119(A), 862 N.Y.S.2d 814 (Sup. Ct. NY 2008) ("Since ... no demands were made, the only issue left ... is whether such a demand would have been futile. The court holds that it would have been. ... Given the identity of interest between [fiduciary] and these closely held business entities, any demand that [fiduciary] ferret out her own wrongdoing would have been futile. Thus, the court holds that in this context no demand was necessary before any derivative action was commenced against the business defendants.")

By a quick sleight of a sure hand, Ocelot drops the word "minority" in front of the word "shareholder," supra, adds the words [or the Manager of the LLC], supra, and Eldan appears to have run afoul of the case law applicable to derivative actions.⁴ Ocelot Memo, p.4.

Ocelot further contends that this Court should nonetheless dismiss the complaint regardless of whether this derivative action is proper because Eldan failed - according to Ocelot - to plead certain elements of a cause of action for the imposition of a constructive trust, i.e., a promise and transfer made in reliance thereon. Ocelot Memo, p.5.

⁴ In reality, Portfolio does not have now - and never had before - a board of directors upon whom a demand could have been made. Portfolio no longer has, but did have, a managing member, Ocelot. Ocelot *qua* manager was fired in May 2009, Katz Aff'n, Ex. 3, and Eytan Shafir - whom Eldan named as Portfolio's manager in May 2009 in place of Ocelot, ibid - resigned a few months later. Krol Aff't, Ex. F.

In reality, Eldan pleaded all four (4) elements of such an action set forth in Sharp v. Kosmalski, 40 N.Y.2d 119, 386 N.Y.S.2d 72 (1976), *i.e.*, (i) a confidential or fiduciary relationship, (ii) a promise, (iii) a transfer in reliance thereon and (iv) unjust enrichment.

Indeed, Eldan alleged that Ocelot was Portfolio's manager and a member of Portfolio holding 20% of membership interest therein. Verified Complaint, ¶3. As a managing member, Ocelot owed a fiduciary duty to Portfolio and Eldan.⁵ See McGuire Children, LLC v. Huntress, 24 Misc.3d 1202(A), 889 N.Y.S.2d 882 (Sup. Erie 2009) ("It is well-settled under New York law that managing members of an LLC owe a fiduciary duty to the LLC and to their fellow members.") citing Out of the Box Promotions, LLC v. Koschitzki, 55 A.D.3d 575, 866 N.Y.S.2d 677 (2d Dept. 2008) ("As a manager of the company, Koschitzki owed a fiduciary duty to both of the plaintiffs.") See also Birnbaum v. Birnbaum, 73 N.Y.2d 461, 541 N.Y.S.2d 746 (1989) ("[I]t is elemental that a fiduciary owes a duty of undivided and undiluted loyalty to those whose interests the fiduciary is to protect. ... This is a sensitive and 'inflexible' rule of fidelity, barring not only blatant self-dealing, but also requiring avoidance of situations in which a fiduciary's personal interest of those owed a fiduciary duty."); Salm v. Feldstein, 20 A.D.3d 469, 799 N.Y.S.2d 104 (2d Dept. 2005); First Keystone Consultants, Inc. v. DDR Constructions Services, 25 Misc.3d

⁵ For this reason alone this action is not duplicative of the Eldan action against Rachel Arfa; Arfa owed fiduciary duty to Eldan because she was an officer and director of Eldan. Ocelot owes a fiduciary duty to Eldan and Portfolio because Ocelot was a managing member of Portfolio.

1217(A), 901 N.Y.S.2d 906 (Sup. Queens 2009) ("A member of a limited liability company also owes a fiduciary duty to other members").⁶

Eldan also alleged that Ocelot - by agreeing to become the manager of Portfolio - undertook to "do on behalf of [Portfolio] all things, which are necessary or appropriate to manage [Portfolio's] affairs and fulfill the purposes of [Portfolio] as specified in this Agreement," Katz Aff'n, Ex. 2 (Operating Agreement), §6.02; LLC Law §409 ("A manager shall perform his or her duties as a manger ... in good faith and with that degree of care that an ordinarily prudent person in a like position would use under similar circumstances.") See Gentile v. Spadaro, 28 Misc.3d 1218(A), 2010 WL 3061798 (Sup. Ct. Queens 2010) ("[A] bilateral contract, ... if proven, would ... constitute a promise, since a bilateral contract is an exchange of promises.") Infra, p.11.

In other words, Ocelot had to manage Portfolio - to the exclusion of self-dealing - for the benefit of its members. Birnbaum, supra. In particular, Ocelot had to close the sale to Hershkovitz in accordance with the contract approved by Eldan, Krol Aff't, Ex. B, and to preserve the proceeds of such sale for Portfolio. Here, of course, Ocelot and its principal, Rachel Arfa, did the opposite. Verified Complaint, ¶¶9-10.

Ocelot's promise to act in the best interests of Portfolio is implied⁷ by virtue of the fiduciary relationship between Ocelot and

⁶ Ocelot will argue in reply that Ocelot was not a member at all, but rather a holder of a contingency interest. *But see* Katz Aff'n, Ex. 2 (Operating Agreement), Schedule A (Ocelot is a 20% member.) Since Arfa drafted, or caused the operating agreement to be drafted, any ambiguity therein is construed against her as the drafter.

⁷ See Sharp v. Kosmalski, supra, at 122 ("[A] promise may be implied or inferred from the very transaction itself.")

Portfolio, on the one hand, and Ocelot and Eldan, on the other hand. Supra, pp. 5-6. See Harbor Consultants Ltd v. Roth, 26 Misc.3d 1219(A), 2010 WL 424091 (Sup. Ct. NY 2010) *citing* Majer v. Schmidt, 169 A.D.2d 501, 564 N.Y.S.2d 722 (1st Dept.) (“[P]laintiff alleges a fiduciary relationship between its predecessor and ... defendants.... Implicit within that relationship was a promise to deal honestly with its assets.”)

Predictably, Ocelot disagrees. Ocelot Memo, p.5 *citing* Maiorino v. Galindo, 65 A.D.3d 525, 883 N.Y.S.2d 589 (2d Dept. 2009). There, unlike here, there was “no allegation that either the plaintiff or [the company] had any preexisting interest or expectation of an interest in the ... property” upon which plaintiff sought to impose a constructive trust. Id. at 527. Here, unlike there, Portfolio - and Eldan as 80% member thereof - obviously had a “preexisting interest or expectation of an interest” in the proceeds of the sale of Portfolio’s 100% membership interest in OCG-VI sold by Portfolio to Hershkovitz. After all, under Portfolio’s operating agreement, Ocelot was not entitled to any portion of the proceeds from the sale by Portfolio of its membership interests in OCG-VI to Hershkovitz since such proceeds constituted “distributable capital cash” thereunder, Operating Agreement, p.4, and distributable capital cash had to be distributed to Eldan, not to Ocelot. Id., §4.01(c).

In reliance on Ocelot’s promise, Sharp v. Kosmalski, supra, Portfolio permitted Ocelot to manage Portfolio’s assets, in general, and to close the sale to Hershkovitz, in particular. Supra. Instead of acting on behalf of Portfolio, Ocelot - in an act of blatant self-

dealing - caused Portfolio to transfer to Ocelot the promissory note made by Hershkovitz to Portfolio, sued Hershkovitz on the note, obtained a judgment on the note from this Court and is about to pocket the identifiable proceeds of its collection activities.⁸

Finally, Eldan pleaded unjust enrichment by alleging that Ocelot had no right to modify the contract with Hershkovitz, no right to close under the modified contract, and - finally - no right to pocket the proceeds thereof, i.e., the note.

While Eldan did plead all four (4) elements of an action for the imposition of a constructive trust set forth in Sharp v. Kosmalski, supra, a failure to do so is by no means fatal to the imposition thereof; New York courts do not always insist thereon and may impose a constructive trust where one or more of the four prongs is missing. See Counihan v. Allstate Insurance Co., 194 F.3d 357 (2d Cir. 1999) ("New York courts do not insist that a constructive trust must fit within the framework of these [Sharp] elements.") citing Palazzo v. Palazzo, 121 A.D.2d 261, 503 N.Y.S.2d 381 (1st Dept. 1986) ("[T]he power of equity to employ a constructive trust to reach a just result is not strictly limited by the conditions set forth in Sharp v. Kosmalski"); see also Tordai v. Tordai, 109 A.D.2d 996, 486 N.Y.S.2d 802 (3d Dept. 1985) (Sharp factors "are not rigid, but

⁸ Eldan expects Ocelot to argue, in reliance on this Court's decision in the Ocelot action, that Eldan is collaterally estopped. *But see* Martin v. Wilks, 490 U.S. 755, 762, 109 S.Ct. 2180 (1989) ("A judgment or decree among parties to a lawsuit resolves issues as among them, but it does not conclude the rights of strangers to these proceedings.") There, as here, an alleged failure to intervene timely was used in the courts below to characterize a subsequent proceeding as an "impermissible collateral attack." Id. 761. Quoting Justice Brandeis, the U.S. Supreme Court held that "a party seeking a judgment binding on another cannot obligate that person to intervene; he must be joined." Id. 763. See Chase National Bank v. Norwalk, 291 U.S. 431, 54 S.Ct. 475 (1934) ("The law does not impose upon any person absolutely entitled to a hearing the burden of voluntary intervention in a suit to which he is a stranger ... Unless duly summoned to appear in a legal proceeding, a person not a privy may rest assured that a judgment recovered therein will not affect his legal rights.")

flexible considerations for the court to apply in determining whether a constructive trust should be imposed"); Coco v. Coco, 107 A.D.2d 21, 485 N.Y.S.2d 286 (2d Dept. 1985) quoting Reiner v. Reiner, 100 A.D. 872, 474 N.Y.S.2d 538 (2d Dept. 1984) ("These factors are merely useful guides and are not talismanic."); In re Koreag, Controle et Revision S.A. v. Refco F/X Associates, Inc., 961 F.2d 341 (2d Cir. 1992) citing Simonds, supra ("Although a fiduciary relationship is one of the factors cited by New York courts, the absence of any one factor will not itself defeat the imposition of a constructive trust where otherwise required by equity. ... Hence New York court have at times dispensed with one or more of these requirements.")

Put differently, a constructive trust is "the formula through which the conscience of equity finds expression," Simonds v. Simonds, 45 N.Y.2d 233, 241, 408 N.Y.S.2d 259 (1978) quoting Beatty v. Guggenheim Exploration Co., 225 N.Y. 380, 386 (1919) (Cardozo, J.), and a proper vehicle to reach "a specifically identified fund" in Ocelot's hands. Sereboff v. Mid Atlantic Medical Services, Inc., 547 U.S. 356, 363, 126 S.Ct. 1869 (2006) ("[Mid Atlantic] alleged breach of contract and sought money, to be sure, but it sought its recovery through a constructive trust or equitable lien on a specifically identified fund, not from the Sereboff's assets generally, as would be the case with a contract action at law.")

The Supreme Court recalled "the familiar rul[e] of equity" in Barnes v. Alexander, 232 U.S. 117, 34 S.Ct. 276 (1914), *i.e.*, "a contract to convey a specific object even before it is acquired will make the contractor a trustee as soon as he gets title to the thing."

There, two lawyers agreed to do work for the third lawyer who promised them "one-third of the contingent fee" he expected to earn in the case, and Justice Holmes upheld their equitable claim to a portion of the fee.

Here, Ocelot, as Portfolio's manager, promised Portfolio and Eldan to do their bidding in conducting Portfolio's business in general and the sale to Hershkovitz in particular. Supra, p.6. In line with this reasoning, Ocelot's undertaking "create[d] a lien" upon Ocelot's monetary recovery from Hershkovitz, which Eldan could "follow... into the hands of... [Ocelot] ... as soon as the fund was identified", Barnes, supra at 123, and seek to impose a constructive trust.

Finally, Ocelot contends that Eldan could not charge Ocelot with conversion as a matter of law because Ocelot had the authority to do what Ocelot did, i.e., to assign to itself the promissory note representing the entire sales proceeds of Portfolio's 100% membership interest in OCG-VI. Ocelot Memo, p.6 ("[Ocelot] did not exercise unauthorized dominion over that property to the exclusion of plaintiff's rights, and ... such dominion was expressly authorized.")⁹

Ocelot's proposition is too preposterous to warrant a serious reply. Simply put, Ocelot posits that the grant of authority to Arfa and Ocelot to act **on behalf of** Portfolio and Eldan is *ipso*

⁹ Eldan expects Ocelot to argue, in reliance on this Court's opinion in Egnotovich v. Katten Muchin Zavis & Rosenman, 18 Misc.3d 1120(A), 856 N.Y.S.2d 497 (Sup. Ct. NY 2008), that Ocelot had, at best, breached the operating agreement, i.e., a contract, but surely did not commit a tort of conversion. Eldan respectfully disagrees. The disbursement of escrowed funds to the client's vendors could have been – arguably – a breach of contract, but not conversion. The disbursement of the escrowed funds into the firm's own account would have been conversion of the client's funds, but not a mere breach of contract. Simply put, the operating agreement, howsoever construed, did not endow Ocelot with the authority to help itself to Portfolio's assets. Otherwise, each treasurer being hauled to jail for theft would cry out, "I merely breached an employment contract!"

facto the grant of authority to act to the **detriment** of Portfolio and Eldan. To paraphrase Ocelot's double negation, Ocelot Memo, p.6, this grant of authority, supposedly found in the operating agreement, §6.01, ibid, allowed Ocelot "to take any actions on behalf of [Portfolio], subject to certain actions requiring the consent of Eldan," ibid, e.g., to convert the proceeds of the sale to Hershkovitz to its own use.

To be sure, under the operating agreement, the sale to Hershkovitz required the consent of Eldan, not Eldan-Tech, Ltd, Ocelot Memo, p.6, but the contract of sale approved by Eldan required, presumably, at the insistence of Eldan, not Arfa, the express consent of Eldan-Tech, Ltd. Krol Aff't, Ex. B.

On or about February 10, 2009, Arfa modified the contract of sale, supra, without the consent of either Eldan or Eldan-Tech, Ltd, and closed, contrary to Eldan's express directions, the deal then and there. Verified Complaint, ¶5. See also Affidavit of Zeev Zur, sworn to August 18, 2010 ("Zur Aff't"), ¶4 ("Mr. Schwab told us that he had no choice but to follow Arfa's express instructions since by then she was - having 'forced' Eytan Shafir to resign at the closing - the sole officer and director of [Eldan-Tech] Inc.") Following the closing, Arfa told Eldan that the promissory note was earmarked either for Eldan or Eldan-Tech, Ltd, and caused Portfolio to assign the note instead to Ocelot. Id., Ex. A (Affidavit of Zeev Zur, sworn to June 2, 2010), ¶8 & Ex. A.

According to Ocelot, all of the foregoing was authorized by the operating agreement and within Arfa's powers as the sole officer

and director of Eldan. Ocelot Memo, p.6 ("Eldan's Verified Complaint alleges that, in February 2009, [Ocelot] was the sole Manager of [Portfolio], that Arfa was the sole officer and director of Eldan...")

In reality, Eldan alleged that Arfa was its sole officer and director "on or about February 10, 2009," not "in February 2009." Compare ibid with Verified Complaint, ¶5 ("On or about February 10, 2009, Arfa, in her capacity as the sole officer and director of Eldan-Tech, Inc., caused Portfolio to sell - without the consent of Eldan-Tech, Ltd., and in the face of its express instruction not to close - it's 100% membership interest in OCG-VI to Hershkovitz...[emphasis supplied].")

This sleight of hand creates an impression that Arfa was, at all relevant times, the sole officer and director of Eldan and acted, at the closing, within the scope of her normal everyday authority. Ocelot Memo, p.6. In reality, until February 10, 2009, the closing date for the sale of 100% membership interest in OCG-VI to Hershkovitz, Eldan had, at all relevant times, two (2) officers and directors, Rachel Arfa and Eytan Shafir. Krol Aff't, Ex. C. Only after Arfa "forced" Eytan Shafir to resign on February 10, 2009, **at the closing**, did she become the sole officer and director of Eldan and accomplished this feat, supra, by deception, force and duress. Zur Aff't, ¶¶4-5. Krol Aff't, Ex. D.

This inequitable (mis)conduct, supra - to put it mildly - and Ocelot's attempts to whitewash Arfa's unclean hands, Ocelot Memo, p.6 - constitute the very basis for the equitable relief sought by Eldan and call for the imposition of a constructive trust.

Conclusion

Beyond dispute, Eldan has standing to sue Ocelot - whether derivatively or individually - and does have a cause of action against Ocelot - whether or not Eldan managed to plead the same. Cf. CPLR §3211(a)(3) & (a)(7). Supra, pp. 2-4.

Beyond dispute, on a motion to dismiss the complaint pursuant to CPLR 3211(a)(7) "the pleading is to be afforded a liberal construction, and the court should accept as true the facts alleged in the complaint, accord plaintiff the benefit of every possible inference, and only determine whether the facts, as alleged, fit within any cognizable legal theory." Frank v. DaimlerChrysler Corp., 292 A.D.2d 118, 121, 741 N.Y.S.2d 9 (1st Dept. 2002) ("[T]he court's role in a motion to dismiss is limited to determining whether a cause of action is stated within the four corners of the complaint, and not whether there is evidentiary support for the complaint.") See also Foley v. D'Agostino, 21 A.D.2d 60, 248 N.Y.S.2d 121 (1964) citing Siegel, 38 St. John's L. Rev., pp. 205-6. ("Under the CPLR, if a cause of action can be spelled out from the four corners of the pleading, a cause of action is stated and no motion lies under rule 3211(a)(7). The pleading can be pathetically drawn; it can reek of miserable draftsmanship. ... We want only to know whether it states a cause of action. If it does, a rule 3211(a)(7) motion does not lie and the pleading is immune from it.")

Beyond dispute, Ocelot's documentary evidence, Katz Aff'n, Exs. 2-4, does not negate, let alone "conclusively establish a defense to," the allegations of the complaint. Weil Gotshal & Manges, LLP v.

Fashion Boutique of Short Hills, Inc., 10 A.D.3d 267, 780 N.Y.S.2d 593 (1st Dept. 2004) ("[D]ismissal is warranted only if the documentary evidence submitted conclusively establishes a defense to the asserted claims as a matter of law.") Construing Eldan's complaint liberally, supra, one cannot fail but to note a significant dispute regarding Ocelot's authority to engage in blatant self-dealing to the detriment of Portfolio and Eldan in violation of Ocelot's fiduciary duty to both.

For the foregoing reasons, Eldan respectfully requests this Court to deny Ocelot's motion to dismiss the complaint.

Dated: New York, New York
August 19, 2010

Respectfully submitted,

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By: _____/s/

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