

SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NASSAU: IAS PART 8

RODEO FAMILY ENTERPRISES LLC, *et*
ano.,

Plaintiffs,

- *against* -

SCOTT MATTE, *et al.*,

Defendants.

Index No.: 600378/2010
(Warshawsky, J.)

MEMORANDUM OF LAW

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Second, even if Defendants had standing to enforce the covenant not to sue—which they do not—their argument is not a proper basis for opposing Plaintiffs’ motion to compel. Defendants waited more than a year after the commencement of this action before purporting to assert a counterclaim for breach of the covenant not to sue in their amended Answers. They have not moved to dismiss (or for summary judgment) on this basis. This discovery motion “is[, thus,] not the appropriate vehicle for resolution of substantive claims.” *Diamond State Ins. Co. v. Utica First Ins. Co.*, 37 A.D.3d 160, 161, 829 N.Y.S.2d 465, 466 (1st Dep’t 2007); *accord Deutsche Bank Trust Co. of Am. v. Tri-Links Inv. Trust*, 43 A.D.3d 56, 62, 837 N.Y.S.2d 15, 22 (1st Dep’t 2007) (lower court lacked authority “to resolve a substantive issue, on the merits and as a matter of law, on a discovery motion”). Defendants should not be permitted to bring discovery to a standstill through the mere assertion (a year into the case) of a new counterclaim or a new affirmative defense to Plaintiffs’ claims. This is especially so because, apart from its discovery obligations in this litigation, OBG is required by statute and contract to provide Rodeo (a member of the LLC) access to the company’s books and records.

II. THE ASSERTION THAT RODEO IS AN “ECONOMIC INTEREST HOLDER” WITHOUT A RIGHT OF ACCESS TO OBG’S BOOKS AND RECORDS HAS NO BASIS IN THE OPERATING AGREEMENT OR THE NEW YORK LLC LAW.

Defendants do not (and cannot) dispute that the New York Limited Liability Company Law, and the OBG Operating Agreement both give members of OBG broad rights to inspect the Company’s books and records. *See* MOL Supporting Mot. to Compel at 3-4; N.Y. Limited Liability Co. Law § 1102(b); OBG Operating Agreement § 6.7(b) (“upon the request of any Member, [OBG] will deliver to such Member such information and data pertaining to the business, financial and corporate (internal) affairs of [OBG] as may be reasonably requested by him.”). As demonstrated in Plaintiffs’ opening brief (at 8-11), these provisions provide a separate basis (apart from the discovery obligations in this litigation) for requiring Defendants to

provide the financial information requested by Rodeo.

Although OBG produced a handful of additional documents (totaling 162 pages) in connection with the parties' unsuccessful settlement discussions, Defendants concede that they have not made a complete production of financial records from the period following Mr. Shah's resignation as a Manager of RJM and OBG. *See* Campolo Affirm. ¶ 6 (asserting only that OBG "has provided many documents from the period post resignation") For example, Defendants have yet to produce:

- Documents concerning the debt portfolios purchased since June 2009.
- The third quarter 2010 financial statements for Oyster Bay and its subsidiaries.
- Documents pertaining to the April or May 2010 presentation to the RJM bank group.

Defendants attempt to justify their failure to abide by the requirements of the LLC law and the OBG Operating Agreement by recycling an argument—already rejected by this Court in its July 19, 2010 Decision and Order (at 6)—that Mr. Shah's resignation as a Manager somehow terminated (or otherwise modified) Rodeo's status as a member of OBG. This argument has no basis in law or in the OBG Operating Agreement.

Mr. Shah was clear in his resignation letter that he was "**not** withdrawing [Rodeo's] membership interest in Oyster Bay Group LLC." *Gionis Affirm.*, Exh. 3 (emphasis added). Nevertheless, Defendants contend that by resigning as an "employee, officer, Manager and fiduciary," *id.*, Mr. Shah somehow "abrogate[d] all rights and indicia of membership." *Id.* ¶ 9. Defendants reason that "[o]ne cannot retain the benefits of membership but shun the obligations." *Id.* This argument simply ignores the fundamental distinction between **Mr. Shah's** role as a Manager of RJM, and **Rodeo's** separate membership interest in OBG. Whatever fiduciary duties Mr. Shah had were solely in his capacity as a Manager, Chief Financial Officer

(and perhaps employee), and therefore terminated upon his resignation from those positions. As this Court made clear in its July 19, 2010 decision and order, following Mr. Shah's resignation, Rodeo remained (and continues to remain) a member of OBG, pending the buy out of its membership interest. But Rodeo, as a member of a Manager-managed LLC, owes no fiduciary duties to its fellow members, the remaining Managers of OBG, or OBG (and never did) for the simple reason that members of a Manager-Managed LLC, like OBG, are not fiduciaries of the company. See MOL in Support of Motion to Strike Matte Defendants' Affirmative Defenses (Mot. Seq. No. 10) at 11-13; MOL in Support of Motion to Strike OBG's Affirmative Defenses (Mot. Seq. No. 12) at 10-12. For these reasons, as this Court recognized in its July 19 Order, Mr. Shah's resignation did not terminate Rodeo's status as a member of OBG.

Equally unfounded is Defendants' alternative contention that, upon Mr. Shah's resignation, Rodeo was no longer a "full fledged member" of OBG, but was instead somehow transformed into an "Economic Interest Holder." Gionis Affirm. ¶¶ 10-11. Defendants cite no case law or statutory authority, and no language in the parties' agreements to support the notion that Rodeo's membership interest was downgraded to a mere "Economic Interest"—and there is no such authority. This is because the concept of an "Economic Interest Owner"² as used in the OBG Operating Agreement has nothing whatsoever to do with the buy out of Rodeo's membership under the 2004 Buy-Sell Agreement. Instead, the term is derived from the provisions of the LLC Law concerning a completely different issue—the transfer of a member's membership interest to a third party in the absence of consent from the other members.

Section 604(a) of the LLC Law provides that, "[e]xcept as provided in the operating agreement, an assignee of a membership interest may not become a member without the vote or

² The term "Economic Interest Holder," which the Matte Defendants use in their opposition papers, appears nowhere in the OBG Operating Agreement. The Agreement defines the term "Economic Interest Owner" as the holder of an Economic Interest—*i.e.*, "the share of a Member in the Company's Net Profits and Net Losses."

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.” Thus, pursuant to Section 603(a) of the LLC Law, subject to the terms of a New York LLC’s operating agreement, the purported assignee of a membership interest who does not receive the consent required by Section 604(a) is entitled only to “the distributions and allocations of profits and losses to which the assignor would be entitled” (*i.e.*, the member’s economic interest), but has no right to “participate in the management and affairs of the limited liability company or to become or to exercise any rights or powers of a member.” Thus, a member can freely transfer its economic interest in a New York LLC’s profits and losses, but cannot force the other members to accept the assignee as a voting member of the LLC with the right to participate in the management of the LLC.

The issue of the assignment of a member’s economic rights to an Economic Interest Owner is dealt with in Article 10 of the OBG Operating Agreement. The Operating Agreement generally limits a member’s right to “assign, transfer or pledge” its membership interest without the written consent of the members holding a Majority Interest. One exception to this requirement, however, (which is consistent with the LLC Law provisions quoted above) permits a member to transfer (on notice, but without prior consent) “**the economic rights, but not the voting rights, attributable to his Membership Interest**” to an immediate family member, or to a trust for the Member’s benefit or the benefit of an immediate family member. Gionis Affirm., Exh. 4 § 10.3. Such a transferee is an Economic Interest Owner within the meaning of the Operating Agreement and the LLC Law, having rights to “a share of the Company’s Net Profits and Net Losses,” but no voting rights.

Thus, there is no basis for Defendants’ assertion that Mr. Shah’s resignation, which triggered OBG’s obligation under the 2004 Buy-Sell Agreement to purchase Rodeo’s

membership interest in OBG, metamorphosized Rodeo's interest from a member to an Economic Interest Owner. This argument is internally inconsistent and cannot be reconciled with the language of the OBG Operating Agreement. As Defendants acknowledge, the Agreement defines an Economic Interest as "the share of a Member in the Company's Net Profits and Net Losses." *Id.* ¶ 10 & Exh. 4 § 1.1(q). But Defendants argue that, when Mr. Shah tendered his resignation as Manager, Rodeo's interest "was reduced . . . to 0% in the profits and losses of [OBG]." ³ *Id.* ¶ 21. In other words, this paradoxical argument is that Rodeo is an Economic Interest Holder that holds no Economic Interest (or voting rights or inspection rights) within the meaning of the Operating Agreement.

Ironically, OBG's counsel originally took the opposite position from the one Defendants are advancing now—*i.e.*, that following Mr. Shah's resignation as Manager, Rodeo was a Member "for voting purposes only, not for economic purposes." See Katz Affirm. in Supp. of Mot. to Compel, dated October 19, 2010 ("Katz Affirm."), Exh. C. That original position, which is diametrically opposed to Defendants' current stance, is equally without support in the law or the Operating Agreement. Moreover, OBG's counsel failed to explain how, as a practical matter, Rodeo could properly exercise its "voting rights" if it is denied access to all information regarding OBG's financial affairs after June 30, 2009.

Indeed, Defendants' current position that Rodeo is a mere Economic Interest Holder turns the provisions of the OBG Operating Agreement and the LLC Law on their heads. As

³ Defendants purport to invoke the authority of OBG's current accounting firm, Holtz Rubenstein Reminick, to support this conclusion. They argue that Holtz Rubenstein "found" that Rodeo's membership interest was reduced to 0% following Mr. Shah's resignation as Manager. Gionis Affirm. ¶ 21. Although the K-1 allegedly prepared by Holtz Rubenstein reflects such a reduction (without explanation), the audited 2009 financial statements Holtz Rubenstein prepared tell a different story. In describing this litigation, the notes to those financial statements prepared by Holtz Rubenstein in December 2010 state: "a complaint was filed by Rodeo Family Enterprises LLC, a **member of [OBG]**" Supplemental Affirmation of Joseph N. Campolo in Opp'n to Planitiffs' Mot. to Compel ("Supp. Campolo Affirm."), Exh. A at Bates No. 010418. In other words, Holtz Rubenstein took the position that Rodeo was a member—not a former member, an "economic interest holder," or a voting-only member with no economic interest—as of the date this suit was filed, which was months after Mr. Shah's resignation.

Defendants would have it, a member who is required to sell his membership interest back to an LLC with the consent of the LLC and the LLC's other members but who has not yet been paid for his membership interest is worse off—both economically and in terms of non-economic rights—than an LLC member who purports to sell his membership interest to a third party without the required consent of the other LLC members.

It is apparent that Defendants' real agenda is to rewrite the terms of the Operating Agreement—just as they have been attempting to rewrite the terms of the agreements specifying the amount Rodeo is supposed to be paid by OBG for its membership interest in OBG—so that they can deny Rodeo the contractual and statutory benefits of membership in OBG without fulfilling their obligation to buy out Rodeo's interest. This Court should reject this invitation to create out of whole cloth a new category of membership interest for LLC members that have not been paid by their LLCs for their membership interests. Accordingly, OBG should be directed to provide Plaintiffs access to all of the books and records sought in their motion to compel, *see* Mot. to Compel at 8-9, including for the period after June 2009.

III. DEFENDANTS' SUPPLEMENTAL PRODUCTION DID NOT CURE THE DEFICIENCIES IN THEIR DISCOVERY RESPONSES.

Plaintiffs' motion to compel demonstrated that Defendants had improperly refused to produce documents and/or provide substantive interrogatory responses regarding: (1) the agreements at the heart of this dispute, and (2) financial information regarding OBG and its subsidiaries that is relevant to (a) the application of the Buy Out Formula and the relevant agreements, (b) Plaintiff Rodeo's Second Cause of Action for breach of fiduciary duty, and (c) Defendants' affirmative defense for alleged "improper competition," which remains an affirmative defense, notwithstanding the Matte Defendants' and OBG's "withdrawal" without prejudice of their counterclaims sounding in improper competition by Mr. Shah.