

Melcher v Apollo Med. Fund Mgt. L.L.C.

2004 NY Slip Op 30147(U)

September 10, 2004

Supreme Court, New York County

Docket Number:

Judge: Herman Cahn

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

PRESENT: _____
Justice

PART 49

0604047/2003

MELCHER, JAMES L.
vs
APOLLO MEDICAL FUND

INDEX NO. _____

MOTION DATE 3/15/04

MOTION SEQ. NO. _____

MOTION CAL. NO. _____

SEQ 2

DISMISS ACTION

The following papers, numbered 1 to _____ were read on this motion to/for _____

MOTION/CASE IS RESPECTFULLY REFERRED TO JUSTICE FOR THE FOLLOWING REASON(S):

Notice of Motion/ Order to Show Cause — Affidavits — Exhibits ...

Answering Affidavits — Exhibits _____

Replying Affidavits _____

PAPERS NUMBERED

Cross-Motion: Yes No

Upon the foregoing papers, it is ordered that this motion

FILED

SEP 14 2004

NEW YORK COUNTY

MOTION IS DECIDED IN ACCORDANCE WITH ACCOMPANYING MEMORANDUM DECISION IN MOTION SEQUENCE

Dated: 9/10/04 _____ *[Signature]*

J.S.C.

Check one: FINAL DISPOSITION NON-FINAL DISPOSITION

Check if appropriate: DO NOT POST

SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK: IAS PART 49

-----x
JAMES L. MELCHER,

Plaintiff,

Index No.
604047/03

-against-

APOLLO MEDICAL FUND MANAGEMENT L.L.C.
and BRANDON FRADD,

Defendants.
-----x

Cahn, J.:

Defendants Apollo Medical Fund Management L.L.C. (Apollo Management) and Brandon Fradd (Fradd) move to dismiss the first amended complaint in its entirety, CPLR 3211 (a) (1), (5) and (7).

Fradd is the manager of Apollo Management, which was formed to act as the general partner of defendant Apollo Medical Partners, L.P. (Apollo Partners), a hedge fund that invests in companies in the biotechnology and medical device industries. On January 8, 1998, Fradd, plaintiff James L. Melcher and non-party Jeff Eliot Margolis entered into the Operating Agreement of Apollo Management (the Operating Agreement), whereby Margolis and Melcher became managers and members of Apollo Management.

Pursuant to the Operating Agreement, Melcher, Margolis and Fradd agreed that Fradd would be compensated based on the percentage of Apollo Partners' assets that existed at the time that Melcher and Margolis became members, and that the three of them would then be compensated equally on the percentage of Apollo

FILED

SEP. 14 2004

COURT

ICE

Partners' assets added thereafter.

According to Fradd, in the months after entering into the Operating Agreement, Margolis and Melcher were involved in other business endeavors and were not devoting much time to fulfilling their commitments to Apollo Management. He states that, in the spring of 1998, he and Margolis agreed that Margolis would be removed as a manager and member of Apollo Management. The removal took place pursuant to a May 13, 1998 amendment signed by Fradd and Melcher (the May 13, 1998 Amendment).

Fradd states that, at that time, he and Melcher also discussed Melcher's lack of participation in Apollo Management. According to Fradd, they agreed to amend Article VII of the Operating Agreement, regarding the allocation of net profits, so that Fradd would receive 100% of the net profits of the assets he brought into Apollo Partners, and Melcher and Fradd would each receive 50% of the net profits of the assets that Melcher brought into Apollo Partners (the Net Profits Amendment). Fradd states that he signed the Net Profits Amendment on May 21, 1998. Melcher never signed the Net Profits Amendment.

Fradd states that he assumed that, pursuant to Article XIV, Section 1, of the Operating Agreement, Apollo Management's counsel had sought and obtained Melcher's approval for the Net Profits Amendment. Fradd contends that, when he signed the Net Profits Amendment, he thought that he possessed an 80.8% interest in the

net profits, such that the Net Profits Amendment would be adopted and effective when he approved it, whether Melcher signed it or not.

Fradd states that, in two October 2003 letters he sent on behalf of Apollo Management, he removed Melcher as a manager and member, which he was authorized to do under the Operating Agreement. Fradd states that, at that time, the profits had been allocated to him and to Melcher pursuant to the Net Profits Amendment for five years, during which time Melcher did not express any disagreement with the allocation. According to Fradd, after Melcher was removed as manager and member of Apollo Management, he asserted that he had been underpaid and that he should have received net profits as allocated in the Operating Agreement.

Melcher denies that his role in Apollo Management was essentially over by May of 1998, but rather asserts that he remained as active as ever, and was in constant communication with Fradd. Melcher asserts that, in mid-2001 he learned that Fradd had set up an offshore branch of Apollo Management, headquartered in Bermuda, called Apollo Medical Offshore Ltd. (Apollo Offshore). Melcher states that, in the hedge fund industry, it is usual and customary to create a separate company, located offshore, to permit investment by retirement funds and offshore investors. Melcher states that, at the time, based on the industry practice, it was his understanding that Apollo Offshore would be managed by Apollo

Management. He argues that, instead, Fradd diverted investors from Apollo Management to Apollo Offshore, which was not managed by Apollo Management.

As far as the purported Net Profits Amendment, Melcher disputes Fradd's allegation that they discussed Melcher's supposed "decreased level of participation" in the business. He also asserts that he never agreed to the net profits allocation set forth in the purported Net Profits Agreement, that Fradd never mentioned the Net Profits Agreement, and that the first time Melcher saw the document was on December 18, 2003.

Melcher states that the Operating Agreement requires that members be provided with a verbatim statement of any amendment by Apollo Management, and that Apollo Management must seek a written vote or call a meeting for a vote (Operating Agreement, Article XIV, Sec. 1). Melcher states that none of this occurred, and that Fradd first showed Melcher the Net Profits Amendment five and a half years after Fradd allegedly signed it.

Furthermore, Melcher states that Fradd correctly notes that the Operating Agreement expressly requires that counsel for Apollo Management approve the form of any proposed amendment. Melcher states that there is no evidence that Apollo Management's counsel approved the Net Profits Amendment. Melcher asserts that the document itself suggests that no law firm was involved, as the purported Net Profits Amendment is physically distinct from the May

13, 1998 Amendment that both Fradd and Melcher signed.

Melcher states that, although he received monthly financial reports for Apollo Partners, the reports did not indicate to him that he was being underpaid. He states that there is no place on those reports that shows that the formula for the allocation of net profits set forth in the Operating Agreement had been changed. Melcher states that, after the end of the year 2000, his estimates of the amounts being credited to him made him think that something was incorrect, and he discussed the underpayment with Fradd. Melcher states that the discussions continued amicably throughout 2002 and 2003, in an on-again, off-again manner. Melcher asserts that in 2003, when Fradd began to increase his efforts to get Melcher to accept a lesser deal, Melcher consulted counsel regarding his negotiations with Fradd.

As to Fradd's removal of Melcher as a member of Apollo Management, Melcher states that, under the operating agreement that was presented to him for review on January 5, 1998, Fradd did not have the power to remove a member unilaterally. Melcher argues that it appears that Fradd secretly had changes made in the document, and presented Melcher with a signature copy of the Operating Agreement without telling Melcher that Fradd had altered the document.

The complaint contains the following seven causes of action:
(1) breach of contract regarding the payment of net profits,

pleaded against Apollo Management; (2) fraud, pleaded against Fradd, for falsely representing that Apollo Partners was closed to new investors; (3) breach of fiduciary duty, against Fradd, alleging that Fradd had a fiduciary duty not to divert investors from Apollo Partners; (4) for reinstatement as a manager, pleaded against both defendants; (5) for reinstatement as a member, pleaded against defendants; (6) for an order to prohibit indemnification of Fradd by Apollo Management, pleaded against defendants; and (7) conversion of net profits owed to Melcher, pleaded against Fradd.

Defendants move for dismissal of all causes of action CPLR 3211, because Melcher fails to state a cause of action his claims are time-barred pursuant to Delaware's statute of limitations, and/or defendants assert a defense founded upon undisputed documentary evidence.

Defendants argue that six of the causes of action, are governed by Delaware law, pursuant to Article XIV, Section 15, of the Operating Agreement. The conversion claim is governed by New York law, because it does not arise out of the Operating Agreement.

As to the statute of limitations issues, however, Melcher correctly points out that New York applies its own statutes of limitations to actions brought by its citizens in New York courts. Sears, Roebuck & Co. v Enco Assocs., Inc., 43 NY2d 389 (1977); Marine Midland Bank, N.A. v United Missouri Bank, N.A., 223 AD2d 119, 122 (1st Dept) ("a purely procedural statute of limitations of

another state is ordinarily no bar to a proceeding in New York"), lv denied 88 NY2d 1017 (1996); Architectronics, Inc. v Control Sys., Inc., 935 F Supp 425, 431 (SD NY 1996) ("New York courts treat statutes of limitations as part of the forum's procedure, and therefore apply New York statutes of limitations even if the underlying claim ultimately will be governed by the substantive law of another jurisdiction"). Thus, the statutes of limitations of New York, not those of Delaware, will be applied, to the extent that they are an issue in this action.

On a motion to dismiss, the pleadings should be liberally construed most favorably for the plaintiff. Cohn v Lionel Corp., 21 NY2d 559 (1968). The plaintiff must be given the benefit of every possible favorable inference. Rovello v Orofino Realty Co., Inc., 40 NY2d 633 (1976).

Defendants argue that the first cause of action, sounding in breach of contract, should be dismissed because Melcher waived the claim and is estopped from asserting it, because the claim is barred by the three-year Delaware statute of limitations, and because that part of Melcher's demand that is for damages based on earnings for reinvestment is prohibited as a matter of law.

The statute of limitations for breach of contract in New York is six years, so a breach of contract claim is not barred by the statute of limitations, CPLR 213. Defendants also cannot rely on waiver and estoppel. "Waiver is the voluntary and intentional

relinquishment of a known right. It implies knowledge of all material facts, and intent to waive." Realty Growth Investors v Council of Unit Owners, 453 A2d 450, 456 (Del 1982). On this motion to dismiss, it is impossible to determine whether Melcher knowingly relinquished the right to be allocated profits based on the formula set forth in the Operating Agreement. In fact, he denies a knowing relinquishment of such right. Also, while "[a]n estoppel may arise when a party by his conduct intentionally or unintentionally leads another, in reliance upon that conduct, to change position to his detriment" (Wilson v American Ins. Co., 209 A2d 902, 903-04 [Del 1965]), there is no indication that defendants relied to their detriment upon any conduct of Melcher. Rather, the net profits that Fradd received from 1998-2003 under the Net Profits Amendment were greater than they would have been under the Operating Agreement.

That part of the breach of contract claim that seeks earnings from reinvestment also survives the instant motion to dismiss. Although Delaware law does not allow future profits as damages for a period beyond the termination date of the contract sued upon, Melcher may be entitled to profits lost during the period for which he was still a member and a manager of Apollo Management. See J.E. Rhoads & Sons, Inc. v. Ammeraal, Inc., 1998 WL 32012, at *9 (Del Super Ct March 30, 1988).

Defendants argue that the second cause of action, sounding in

fraud, should be dismissed because Melcher fails to plead the elements with detail. Melcher alleges that Fradd knowingly represented to him that Apollo Partners was closed to new investors, that the representation was knowingly false, and that, but for the false representation, Melcher would have brought new investors into Apollo Partners. Defendants argue that these claims are insufficient in detail to satisfy the fraud standards of either Delaware or New York. Defendants point out that Melcher does not allege when Fradd made the representation, how many times it was made, how it was made, or any other details about the alleged misrepresentation.

Delaware's Court of Chancery Rule 9 (b) states: "In all averments of fraud ... the circumstances constituting fraud ... shall be stated with particularity. Malice, intent, knowledge and other condition of mind of a person may be averred generally."

"The 'circumstances' which must be stated with particularity under Rule 9 (b) refer to 'the time, place, and contents of the false representations, as well as the identity of the person making the misrepresentation and what he obtained thereby.'" Nutt v A.C. & S., Inc., 466 A2d 18, 23 (Del Super 1983) affd sub nom. Mergenthaler v Asbestos Corp. of America, 480 A2d 647 (Del 1984), quoting Autrey v Chemtrust Indus. Corp., 362 F Supp 1085, 1092, 1093 (D Del 1973). The particularity requirement is not satisfied in the instant pleadings, and, therefore, the second cause of

action is dismissed.

Defendants maintain that the court should dismiss Melcher's third cause of action, sounding in breach of fiduciary duty, because Melcher does not show that such a duty existed. Defendants argue that Melcher does not demonstrate that Fradd had a fiduciary duty NOT to divert investors into Apollo Offshore. On a motion to dismiss, the court cannot find, as a matter of law, that Fradd did not have any fiduciary duty to Melcher regarding diversion of investors to other companies that were not managed by Apollo Management. Melcher states that Apollo Offshore was created in 2001, and this action was commenced in 2003, such that there is no statute of limitations issue, given that the statute of limitations for breach of fiduciary duty in New York is three years or six years, depending on the remedy sought. See Kaufman v Cohen, 307 AD2d 113 (1st Dept 2003). Therefore, the motion is denied as to the third cause of action.

Defendants argue that the fourth and fifth causes of action should be dismissed because the Operating Agreement gave Fradd authority to remove Melcher as a manager and as a member.

Article V, Section 1, of the Operating Agreement, as amended by the May 13, 1998 Amendment, states:

The ordinary and usual decisions concerning the business affairs of the Company shall be made by the Managers. There shall be two managers until such number is increased or decreased by the consent of the Managers, which consent must include that of R. Brandon Fradd. Subject to Section 3 below, the managers shall be R.

Brandon Fradd and James Melcher.

Article V, Section 2, states, in part: "Each Manager shall serve until the earliest of ... his removal by the other Managers with or without cause."

The above language, as a matter of law, does not unequivocally grant Fradd the authority to unilaterally remove Melcher as a manager. It is very possible that the power of removal was reserved to any two managers acting jointly, and could not be exercised by any one manager acting alone. Therefore, the fourth cause of action, seeking reinstatement as a manager, survives the instant motion to dismiss.

Article X, Section 1 (g) provides that "A Person shall cease to be a Member upon ... ten (10) days prior written notice to such Person by R. Brandon Fradd." Melcher asserts that the version of the Operating Agreement that he signed on January 8, 1998, containing Article X, Section 1 (g), is a material change from the contract presented to him on January 5, 1998, which provided that if there were only two remaining Managers, the unanimous vote of both of them was required to remove a member. As evidence, Melcher submits the version he received on January 5, 1998.

Fradd asserts that Melcher's claim that the court should disregard Article X, Section 1 (g) because Melcher did not read the Operating Agreement before he signed it is not in accordance with basic contract law.

Melcher states that, sometime between January 5, 1998 and January 8, 1998, he reviewed the contract presented to him on January 5, 1998, and agreed to sign it. He states that the signature copy was given to him for signature, and that, at that time he was not informed of, nor aware of, any change in the language of the Operating Agreement. The fifth cause of action, seeking reinstatement as a member, survives the instant motion to dismiss, in order to allow the parties to further develop necessary facts, including how and when the change to Article X, Section 1 (g), was made, and how it was or was not presented to Melcher. Certainly such an issue can not be decided on a CPLR 3211 motion; it probably could not even be decided on a CPLR 3212 motion.

Defendants assert that the court should dismiss the sixth cause of action for a declaration of no indemnification because indemnification is mandatory unless plaintiff can prove "fraud, bad faith, willful misconduct or gross negligence." (Operating Agreement, Art. IV, Sec. 4 [c]). They assert that, if the court dismissed the cause of action for fraud, it must dismiss this claim as well. Although the fraud claim is dismissed, the allegations in some of the other causes of action may reach the level of bad faith. Therefore, the sixth cause of action survives the instant motion to dismiss.

Defendants maintain that the court should dismiss the seventh cause of action for conversion because Melcher does not plead the

elements of conversion, and his claim is merely a breach of contract cause of action. In addition, they argue that Melcher cannot sustain a cause of action for conversion because he never had ownership, possession or control of the funds allegedly due to him.

"[A]n action for conversion can not be validly maintained where damages are merely being sought for breach of contract." Peters Griffin Woodward, Inc. v. WCSC, Inc., 88 AD2d 883, 884 (1st Dept 1982). The conversion claim is duplicative of the breach of contract claim. Therefore, the seventh cause of action is dismissed.

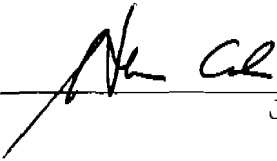
Melcher attaches a second amended complaint, but defendants state that it has not yet been served on them, and they have not responded to it by motion or answer. The court will also not address the allegations therein at this time.

Accordingly, it is

ORDERED that the motion to dismiss is granted in part, to the extent of dismissing the second and seventh causes of action, and the motion is otherwise denied; and it is further

ORDERED that defendants are directed to serve an answer to the complaint within 10 days after service of a copy of this order with notice of entry.

Dated: September 9, 2004

ENTER: 

J.S.C.

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