

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

2006 NY Slip Op 30206(U)

March 30, 2006

Supreme Court, New York County

Docket Number:

Judge: Herman Cahn

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SCANNED ON 4/3/2006
SUPREME COURT OF THE STATE OF NEW YORK — NEW YORK COUNTY

PRESENT: ~~ROSEMARY CAHILL~~
Index Number : 604047/2003

PART 49

MELCHER, JAMES L.

vs
APOLLO MEDICAL FUND

Sequence Number : 010

CONFIRM/REJECT REFEREE REPORT

C

INDEX NO. _____

MOTION DATE 2/27/06

MOTION SEQ. NO. 010

MOTION CAL. NO. _____

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

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

**MOTION IS DECIDED IN ACCORDANCE
WITH ACCORDANCE WITH THE COURT'S ORDER AND
DECISION IN MOTION SEQUENCE**

FILED
APR 03 2006
COUNTY CLERK'S OFFICE
NEW YORK

Dated: 3/30/06

James L. Melcher

J.S.C.

Check one: FINAL DISPOSITION NON-FINAL DISPOSITION

Check if appropriate: DO NOT POST REFERENCE

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

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

-----X
JAMES L. MELCHER, :
 : Index No. 604047/03
 :
 Plaintiff, :
 :
 - against - :
 :
 APOLLO MEDICAL FUND MANAGEMENT :
 L.L.C. and BRANDON FRADD, :
 :
 Defendants. :
-----X

Herman Cahn, J.

Defendants move (seq. no. 10) for review of an order made by a referee to supervise disclosure, CPLR 3104 (d), and related relief.

Background:

A full statement of the background hereof is set forth in the court's decision and order dated September 9, 2004 (the "Decision"). To summarize, as of January 8, 1998, plaintiff was a managing member of defendant LLC, an investment management company. He was ousted from the LLC by defendant Fradd, another managing member, on October 24, 2003. Plaintiff commenced this action, challenging his removal as a breach of the operating agreement and alleging other causes of action. Defendants moved to dismiss the complaint. The Decision granted the motion only as to two causes of action, for breach of fiduciary duty, and conversion by Fradd of company assets (*affd* 25 AD3d 482 [1st Dept 2006]). Nine causes of action remain.

The breach of contract claim, sustained by the court, seeks sums claimed to be due to plaintiff under the operating agreement, which include earnings from reinvestment of company revenues (Complaint ¶ 46). The Decision stated, at page 8:

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).

Plaintiff served a document demand seeking financial and audit reports concerning defendant LLC and two other entities, Apollo Medical Partners, L.P. (“Apollo Partners”), and Apollo Medical Offshore, Ltd. (“Apollo Offshore”). Defendant LLC is alleged to be the general partner of Apollo Partners (Complaint ¶ 8); Apollo Offshore is alleged to be a hedge fund established by Fradd in 2001 “whose investment aims are identical to or very similar to” Apollo Medical Partners, L.P. (*id.*, ¶ 28). The document demands broadly seek the production of said financial and audit reports from the inception of the Apollo companies through the date of trial (Notice of Motion Ex. E).¹ Defendants objected on grounds of overbreadth and irrelevance (*id.*).

By short form order dated January 25, 2005, Hon. Beverly Cohen, J.H.O., was appointed referee to supervise disclosure, CPLR 3104 (b) (Notice of Motion Ex. G). Judge Cohen issued an order in respect of the foregoing objections. She essentially overruled them by directing defendants to produce (1) monthly financial reports of the Apollo entities from December 31, 2003 – the time of plaintiff’s ouster – to the present, and audit reports of same; and (2) quarterly reports of Apollo Offshore to its investors from its inception in 2001 to the present.

Defendants now move for review and vacatur of that determination. In the alternative, they seek bifurcation of the trial as to issues of liability and damages, and an order

¹ There is no dispute that defendants have produced such material for the period prior to plaintiff’s removal.

staying any post-removal discovery until a determination is made as to liability.

Discussion:

CPLR 3101 (a) permits “full disclosure of all matter material and necessary in the prosecution or defense of an action, regardless of the burden of proof” However, while this standard favors liberal production, the court retains the authority to assess whether document demands truly seek relevant material, or whether they are “used as a tool of harassment or for the proverbial ‘fishing expedition’” (*Reuters Ltd. v Dow Jones Telerate, Inc.*, 231 AD2d 337 [1st Dept 1997].)

Defendants assert that the financial reports and related audits of the Apollo entities, from the time of plaintiff’s ouster in December 2003 through the present, are not material and necessary to this action, because the Decision held, at page 6, that Delaware law affords plaintiff a claim to future profits only with regard to the time when plaintiff was a member of the company. Defendants posit that since plaintiff was “properly removed” by them in December 2003 (Def. Mem. at 1), he could not possibly be entitled to any profits earned after that point (*id.*, at 6).

Defendants’ argument presupposes ultimate success on its key allegation that, in fact, their removal of plaintiff was proper. Obviously, if plaintiff was improperly removed, as the complaint alleges, post-removal earnings may very well be relevant to damages assessment. Granted; plaintiff bears the burden of proving his allegation of improper removal. Defendants, however, cannot transform a key fact in issue into a basis for what is, in essence, a request for a

protective order.² CPLR 3101 (a) makes clear that relevant material is discoverable “regardless of the burden of proof.”

Accordingly, no basis exists to definitively preclude disclosure of the material sought in plaintiff’s document demands, detailed above.

On the other hand, defendants more aptly posit that the material requested is “private financial information . . . such as: (1) comparative statements of financial condition; (2) statement of operations; (3) trial balance; (4) partners’ allocation spreadsheet; and (5) a condensed schedule of investments” (Def. Mem. at 6). Defendants are justified in their concern over the production of such information, as plaintiff now competes with them in the same industry (*id.*, at 6-7).

Judge Cohen recognized the proprietary nature of the post-removal information sought. Accordingly, she qualified her order to produce by allowing defendants to make the within motion, *inter alia*, for bifurcation (Notice of Motion Ex. A).³ She stated:

[D]efendants are directed to provide plaintiff with monthly reports prepared for Apollo Offshore and Apollo Mgt/Partners as well as annual audits of those reports from date of prior production to present unless there is a decision on a defendants’ motion made w/in 10 days to bifurcate discovery as to liability and damages.

(Emphasis added.)

² The Appellate Division’s affirmance of the Decision acknowledged the key issue in the case: “the complaint adequately pleads that his removal as a member of the Company was in violation of the parties’ agreement” (25 AD3d 482 [1st Dept 2006]).

³ Plaintiff’s counsel is, therefore, wrong to suggest that defendants present “no arguments for bifurcation, other than that defendants don’t want to comply with Justice Cohen’s order” (Jannuzzo Aff. ¶ 25). Judge Cohen herself conditioned her order on defendants not moving for bifurcation. Thus, defendants’ action in making this motion is in full compliance with the terms of her order.

Bifurcation is proper where the issue of liability is not intertwined with the issue of the quantum of damages (*e.g.*, *Szeztaye v LaVacca*, 179 AD2d 555 [1st Dept 1992]).

The primary issues in this case – whether plaintiff's removal as member and manager was authorized, and whether his compensation was governed by Fradd's May 21, 1998, net profits amendment to the operating agreement – do not appear to depend, substantively, on evidence of company earnings, etc., after the time of his removal. Rather, they depend, *inter alia*, on the weight of evidence supporting the following respective allegations of the parties:

1. According to Fradd, in the months after entering into the operating agreement, Melcher was involved in other business endeavors and not devoting much time to fulfilling his commitments to Apollo Management.
2. According to Fradd, the parties 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).
3. Fradd contends 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.
4. Fradd contends that at the foregoing 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.
5. Melcher contends that he did not neglect his duties to Apollo; but rather, 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.
6. Melcher contends that Fradd diverted investors from Apollo Management to Apollo Offshore, which was not managed by Apollo Management.
7. Melcher asserts that he never agreed to the net profits allocation set forth in the 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.

8. Melcher contends 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 alleges 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.

None of the foregoing issues depends on evidence of post-removal financial status of the Apollo entities. Consequently, the motion is granted to the extent that bifurcation is ordered, and discovery of post-removal financial reports and audits of the Apollo entities is stayed pending a trial on liability and further order of the court.

As for the document demand seeking quarterly reports from Apollo Offshore, it appears that Judge Cohen did not qualify her direction to produce that material on the bringing or non-bringing of a motion for bifurcation (*see*, Notice of Motion Ex. A).⁴ The third cause of action in the complaint relates to Apollo Offshore. It alleges that Fradd established the entity to divert investors away from Apollo Partners, thereby depriving defendant Apollo Medical Fund Management L.L.C. of fees. Apollo Offshore's quarterly reports may, indeed, have relevance to such matters. As they are addressed to Apollo Offshore's investors, they may (or may not) contain evidence of efforts by Fradd to divert Apollo Partners investors to Apollo Offshore.

Unlike the post-removal financial reports and audits of the Apollo entities treated above, the quarterly reports to Apollo Offshore investors are related to the liability phase of the case by virtue of their possible probative value on the issue of Fradd's efforts to augment Apollo Offshore at the expense of Apollo Partners. Consequently, the within bifurcation of liability and damages will not serve to prevent disclosure of the quarterly reports at this time, per Judge Cohen's order.

⁴ She did, however, order the redaction of the names of Apollo Offshore investors.

Accordingly, it is

ORDERED that defendants' motion is granted to the extent that the issues of liability and damages herein shall be bifurcated and tried separately, with the issues of liability being tried first; and it is further

ORDERED that defendants' objections to plaintiff's document demands seeking financial reports and audits of the Apollo entities from December 31, 2003 to the present, are sustained until after the trial on liability and further order of the court; and it is further

ORDERED that defendants' objections to plaintiff's document demands seeking quarterly reports from Apollo Offshore are overruled, subject to Judge Cohen's order of redaction relating thereto; and it is further

ORDERED that said quarterly reports shall be produced, as redacted, no later than 20 days from the date of service of a copy of this decision with notice of entry, on defendants' counsel.

Dated: March 30, 2006

ENTER:


J. S. C.

FILED
APR 03 2006
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