SHORT FORM ORDER

SUPREME COURT - STATE OF NEW YORK

Present:

HON. STEPHEN A. BUCARIA

Justice

TRIAL/IAS, PART 1
NASSAU COUNTY

JOEL SACHER and SUSAN SACHER, derivatively on behalf of BEACON ASSOCIATES LLC II,

INDEX No. 005424/09

MOTION DATE: Nov. 7, 2011
Motion Sequence # 013

Plaintiffs,

-against-

BEACON ASSOCIATES MANAGEMENT CORP., IVY ASSET MANAGEMENT CORP., IVY ASSET MANAGEMENT LLC, FRIEDBERG, SMITH & CO., P.C., JOEL DANZIGER and HARRIS MARKHOFF,

Defendants,

-and-

BEACON ASSOCIATES LLC II,

Nominal Defendant.

The following papers read on this motion:

Notice of Motion..... X
Affirmation in Opposition..... X
Affirmation in Support..... X
Memorandum of Law..... XX
Reply Memorandum of Law..... X

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Motion by plaintiffs for leave to reargue defendant Ivy Asset Management LLC's motion to dismiss the complaint to the extent the court dismissed the first, second, and fourth causes of action in the first amended derivative complaint is **denied**.

This derivative action against the managing member of an investment company, its investment consultant, and the company's auditor arises from the collapse of Bernard L. Madoff Investment Securities. Two other actions asserting almost identical claims are also pending in this court. ***Hecht v Andover Associates***, No. 6110/09, is assigned to the undersigned, and ***Bailey v Peerstate***, No.12439/09, is assigned to Justice Driscoll.

Beacon Associates, LLC II ("Beacon Associates") was a New York limited liability company formed for the purpose of investing and trading in securities, financial instruments and commodities for its own account. The firm commenced operations March 1, 1995.

Beacon Associates' amended and restated operating agreement provides that the managing member is defendant Beacon Associates Management Corp. ("Beacon Management"). The amended and restated operating agreement provides that the managing member shall make the "ordinary and usual decisions concerning the business affairs" of the company. The managing member's duty of care in discharging its duties was limited to "refraining from engaging in grossly negligent or reckless conduct, intentional misconduct or a knowing violation of law." The managing member was to be "fully protected in relying in good faith upon... investment managers or agents...as to matters the managing member reasonably believes are within such other person's professional or expert competence and who have been selected with reasonable care by or on behalf of the company...."

As compensation for managing the company, the managing member was to receive a monthly "managing member fee" of .125 % of the "capital account balance of each member (other than the managing member) attributable to non-Beacon net worth." Non-Beacon net worth" was defined as total assets of the company not committed to Beacon investments less liabilities not related to Beacon investments. The operating agreement further provides that the investment consultant fee shall be paid by the managing member from the managing member fee and shall not be charged to the company.

On February 17, 1995, Ivy Asset Management entered into an "administrative services" agreement with Beacon Management. The agreement recited that Ivy had introduced Danziger and Markhoff to Madoff and that they intended to form "Beacon Associates, LLC" for the purpose of investing with Madoff's company. The agreement

further recited that Beacon Management was to be the sole managing member of the LLC and that Ivy would provide certain administrative services for Beacon Management. Those services included, among other things, maintaining the capital accounts of the LLC members, reconciling all Madoff statements against "trade tickets," and maintaining "original books of entry for all Madoff activity."

As compensation for these services, Ivy was to be paid 50% of all fees received by the managing member from the LLC. On January 1, 2006, Ivy entered into an agreement with Beacon Associates to provide administrative services "of the same nature" directly to the LLC for a fee of $70,000 per year. Pursuant to a January 1, 2008 amendment to the administrative services agreement, Ivy's annual fee was changed to .1% of the net capital of the LLC.

In June, 2000, Beacon Associates issued a "confidential offering memorandum," offering prospective investors the opportunity to invest in the limited liability company. Although the offering memorandum referred to the interests it was offering as "securities," it stated that the offering was not a "public offering."

The offering memorandum contained a liability and indemnification provision which provided that, "Neither the managing member, nor the investment consultant, or their respective shareholders, officers, directors...will be liable ...to the company or any of the members for any act or omission performed or omitted to be performed...in a manner reasonably believed by it or them 1) to be within the scope of the authority granted...by the LLC agreement, and 2) to be in the best interests of the company or the members (... "good faith acts"), except when such action or failure to act is found to be the result of gross negligence, fraud, or willful misconduct." A similar indemnification and limitation of liability provision was contained in the amended and restated operating agreement.

On November 28, 2005, Beacon Management entered into a "letter agreement" with Ivy Asset Management Corp. The letter agreement recited that Ivy was currently performing consulting services for Beacon Management as well as administrative services to Beacon Associates LLC I and Beacon Associates LLC II. The agreement recited that as compensation for performing these services, Ivy was currently being paid 45% of the managing member fees received by Beacon Management from Beacon Associates I and II, and 50% of the managing member's "1 % profit allocation." The agreement further recited that "historically" Beacon Management had paid the entire amount of these fees out of its managing member fees, even though the operating agreements required the companies to pay for their own administrative services.

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On January 1, 2006, Beacon Associates entered into an administrative services agreement with defendant Ivy Asset Management Corp. The administrative services to be performed included maintaining capital accounts of the LLC members, reconciling Madoff statements against trade tickets, and maintaining original books of entry for all Madoff activity. As compensation for performing these services, Ivy was to receive $70,000 per year. Plaintiffs allege that in 1995, upon the recommendation of Ivy, Beacon Associates invested all of its assets with Madoff. For many years, Madoff purported to pay Beacon Associates a high rate of return on its investment. However, in December, 2008, it became known that Madoff had been running a "Ponzi scheme," whereby no profits were actually being earned but rather earlier investors were paid "profits" from the capital of newer investors. Madoff subsequently declared bankruptcy and was convicted of fraud, perjury, and other crimes in connection with his criminal enterprise. Beacon Associates alleges that at the time of his collapse, it had $75 million of assets invested with Madoff and Beacon lost its entire investment.

The present action was commenced on March 24, 2009. Plaintiff purports to sue derivatively on behalf of Beacon Associates LLC II.

The first cause of action is asserted against Ivy for breach of the 1995 administrative services agreement by failing to reconcile Madoff's monthly statements against the trade tickets. Plaintiffs allege that had Ivy attempted to reconcile Madoff's monthly statements, it would have discovered that no trades were ever executed and Beacon Associates would have been able to withdraw its investment.

The second cause of action is asserted against Ivy for breach of the 2006 administrative services agreement. Similar to the first cause of action, plaintiffs allege that Ivy breached this agreement by failing to reconcile Madoff's monthly statements against the trade tickets.

The third cause of action is asserted against Beacon Management for breach of the operating agreement. Plaintiffs allege that Beacon Management violated the provision in the operating agreement that the investment consultant's fee shall not be charged to the company by arranging for the administrative services fee to be paid by Beacon Associates.

The fourth cause of action is asserted against Ivy for negligence. Plaintiffs allege that Ivy was negligent in recommending Madoff as an investment manager without conducting sufficient due diligence investigation of his operation.

The fifth cause of action is asserted against Beacon Management for gross negligence. Plaintiffs allege that Beacon Management was grossly negligent by investing a substantial portion of Beacon's assets with Madoff without conducting a sufficient due diligence investigation.

The sixth cause of action is asserted against Beacon Management for breach of fiduciary duty. Plaintiffs allege that Beacon Management breached its fiduciary duty of loyalty by entering into the 2006 consulting agreement, whereby Ivy disclaimed any responsibility for monitoring Madoff; causing Beacon Associates to enter into the 2006 administrative services agreement in violation of the provision in the operating agreement that the investment consultant fee not be paid by the company; and causing Beacon to enter into the 2008 amendment to the administrative services agreement resulting in an increase in the administrative services fee.

The seventh cause of action is asserted against the principals of Beacon Management, defendants Joel Danziger and Harris Markhoff, for aiding and abetting Beacon Management to breach its fiduciary duty. The eighth cause of action is asserted against Ivy for aiding and abetting Beacon Management's breach of fiduciary duty. The ninth cause of action is asserted against defendant Friedberg, Smith & Co. for auditor's negligence.

By order dated April 26, 2010, the court denied defendants Danziger, Markhoff, Beacon Management and Ivy's motion to dismiss the amended complaint for lack of capacity to sue on the ground that a demand upon Beacon Associates would have been futile. The court further denied defendants' motions to dismiss plaintiffs' breach of fiduciary duty, aiding and abetting, gross negligence, and auditor negligence claims as preempted by the Martin Act, General Business Law § 352. The court denied defendants' motions to dismiss plaintiffs' breach of the operating agreement, gross negligence, aiding and abetting, and auditor negligence claims for failure to state a cause of action. The court denied defendant Friedberg, Smith's motion to dismiss the complaint based upon the statute of limitations. However, the court granted defendant Ivy's motion to dismiss plaintiffs' first cause of action, breach of the 1995 administrative services agreement, on the ground it was duplicative of the negligence claim.

At around the same time the present action was commenced, certain related actions were commenced in the United States District Court for the Southern District of New York. By order dated May 13, 2009, Judge Sand consolidated ***Cacoulidis v Beacon Associates Management*** (No. 09 civ 0777); ***Raubvogel v Beacon Associates, LLC I*** (No. 09 civ 2401); and ***Plumbers Local 112 Health Fund v Beacon Associates Management***, (No. 09 civ

3202). The ***Cacoulidis*** action was filed on January 27, and the ***Raubvogel*** action was filed on March 15, 2009. A fourth case, ***Towsley v Beacon Associates Management***, (No. 09 civ 4453) was also covered by the consolidation order. The consolidated federal action is brought as a class action on behalf of all Beacon investors, other than insiders such as Danziger and Markhoff.

By order dated October 5, 2010, Judge Sand dismissed the state law derivative claims, except the claim for auditor negligence, on the ground that the claims were preempted by the Martin Act (But see **Assured Guaranty v J. P. Morgan Investment**, N.Y. Court of Appeals, December 20, 2011). Thus, at present, the only claims remaining in the federal action are direct claims under ERISA and the federal securities laws.

In their answer filed in the federal action on December 20, 2010, defendants Beacon Associates LLC I and Beacon Associates LLC II assert certain counterclaims. Defendants assert a claim against Beacon Management for return of certain indemnification payments. Defendants seek a declaratory judgment that Ivy is required to indemnify the Beacon Fund for all claims arising out of Ivy's gross negligence. Defendants also assert claims for contractual indemnification against Ivy; common law indemnification against Beacon Management, Ivy, Danziger, Markhoff, and certain individuals, Simon and Wohl, who were apparently employed by Ivy; fraud against Ivy, Simon, and Wohl; and violation of § 10b-5 of the Securities Exchange Act against Ivy, Simon, and Wohl.

By order dated August 11, 2011, this court granted defendants' motion to renew their motions to dismiss the complaint based upon subsequent proceedings in the federal court. Upon renewal, the court granted defendant Ivy's motion to dismiss plaintiffs' second cause of action, breach of the January 2006 administrative services agreement, based on Martin Act preemption. The court dismissed this claim as a matter of comity because it had already been dismissed by Judge Sand (***McLearn v Cowen & Co.***, 48 NY2d 696 [1979]). Additionally, the court granted defendant Ivy's motion to dismiss plaintiffs' fourth cause of action for negligence based upon lack of capacity to sue. The court determined that the counterclaims asserted by Beacon Associates in federal court sound in gross negligence as to Ivy and indemnity and fraud as against the other defendants. Since a shareholder lacks standing to bring a derivative action once the corporation elects to sue in its own right, plaintiffs no longer had standing to sue Ivy based on the negligence claim (***Silver v Chase Manhattan Bank***, 49 AD2d 851 [1st Dept 1975]).

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Plaintiffs move for leave to reargue defendant Ivy Asset Management LLC's motion to dismiss the complaint to the extent that the court dismissed the first, second, and fourth causes of action in the first amended derivative complaint. In support of the motion, plaintiffs assert that the court erroneously referred to the second cause of action as being based upon a consulting agreement rather than the administrative services agreement. As a matter of comity, this court is equally bound by the judgment of Judge Sand, regardless of how the agreement is characterized. Given the New York Court of Appeals decision in **Assured Guaranty v J. P. Morgan Investment,** Judge Sand may revise his ruling on Martin Act preemption. However, plaintiffs appear to lack standing to sue on the administrative services agreement because Beacon has asserted a claim on that agreement in the federal action.

The court has considered plaintiff's other arguments and they are without merit. Plaintiffs' motion for leave to reargue defendant Ivy Asset Management LLC's motion to dismiss the first, second, and fourth causes of action is **denied**.

So ordered.

Dated JAN 03 2012

Stephen A. Bucaria
J.S.C.

ENTERED
JAN 05 2012
NASSAU COUNTY
COUNTY CLERK'S OFFICE