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: June 15, 2011
Motion Sequence # 009, 010, 011, 012

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
Cross-Motion..... XXX
Affirmation in Opposition..... X

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Affirmation in Support..... XX
Reply Affirmation..... XX
Memorandum of Law..... XXX
Reply Memorandum of Law..... XX

Motion by plaintiffs to lift the stay is **granted**. Motion by defendants Beacon Associates Management Corp., Joel Danziger, and Harris Markhoff to dismiss the complaint is **denied**. Motion by defendant Friedberg, Smith & Co. to dismiss the complaint is **denied**. Motion by defendants Ivy Asset Management Corp. and Ivy Asset Management LLC to dismiss the complaint is **granted** in part and **denied** in part.

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 for its own account "in securities, financial instruments and commodities of every kind and description." The firm commenced operations March 1, 1995, and it is governed by an amended and restated operating agreement. Beacon Associates' amended and restated operating agreement provides that the managing member is defendant Beacon Associates Management Corp. ("Beacon Management"). Defendant Joel Danziger is the president and a director of Beacon Management, and defendant Harris Markhoff is the vice president, secretary, treasurer and a director of the corporation.

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 pooling investment funds to be managed by Madoff. 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," including "purchase and sales 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 stated that the "investment objective" of the partnership was to provide "above average rates of return while attempting to minimize risk." However, the offering memorandum stated that the investment was not suitable for someone who could not "afford a loss of principal" or had "need for liquidity." It further stated that the "minimum initial purchase" was $500,000.

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. The letter agreement recited that, effective January 1, 2006, Beacon Associates I and II would begin paying Ivy a total of $70,000 per year, which was the portion of Ivy's total fees which Ivy had determined should be "allocated" to the administrative services.

On January 1, 2006, Beacon Management entered into a consulting agreement with defendant Ivy Asset Management Corp. The consulting agreement recites that Ivy originally recommended Madoff to Beacon Management and that Beacon Management "continues to utilize the strategies implemented by Madoff." The consulting agreement provided that Ivy would recommend other investment managers to Beacon Management and advise the company as to the "allocation of LLC funds" among investment managers, including "timing of retaining and terminating investment managers other than Madoff." In the agreement, the parties acknowledged that Beacon Management had expressly requested that Ivy "not monitor or evaluate or meet with any representatives of Madoff...or with any non-recommended manager." Although Ivy agreed to use reasonable care in providing these services, it was not to "be responsible or held accountable for any act or failure to act by investment managers regardless of whether it recommends such managers or by Madoff."

As compensation for performing the consulting services, Ivy was to receive 40% of the managing member fees received by Beacon Management from January 1 through December 31, 2006. Commencing January 1, 2007, Ivy was to receive 37.5 % of the managing member fees received by Beacon Management. Additionally, Ivy agreed to indemnify Beacon Management for all claims arising from Ivy's gross negligence or wilful misconduct, and Beacon Management agreed to indemnify Ivy for claims arising from

similar conduct on the part of Beacon Management.

Although plaintiffs allege that they were members of Beacon Associates, they do not set forth the amount of their investment or the circumstances surrounding the acquisition of their interests. Nevertheless, plaintiffs allege that in 1995, upon the recommendation of Ivy, Beacon Associates invested all of its assets with Madoff. For many years, Madoff paid 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. While the percentage of Beacon Associates' assets invested with Madoff had fluctuated over the years, at the time of his collapse, 75%, or $75 million, of Beacon Associates' assets were invested with Madoff.

The present action was commenced on March 24, 2009. Plaintiff purports to sue derivatively on behalf of Beacon Associates LLC II. In addition to Danziger, Markhoff, and Beacon Management, plaintiff names as defendants Ivy and Friedberg, Smith & Co. P.C., who is the auditor for Beacon Associates.

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 there were no trade tickets because no trades were ever executed. Thus, plaintiffs allege that, but for Ivy's failure to reconcile the statements, Madoff's fraud would have been discovered earlier and Beacon Associates would have been able to withdraw its investment. Plaintiffs claim that, as a result of Ivy's breach of the administrative services agreement, Beacon sustained damages in the amount of approximately $75 million, allegedly the value of its Madoff 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 Danziger and 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 Friedberg, Smith for auditor's negligence. Plaintiffs allege that Friedberg, Smith failed to conduct a proper audit, including obtaining confirmations of portfolio securities purportedly held by Madoff's firm. Plaintiffs assert that but for the auditor's negligence, Beacon Associates would not have invested 75% of its assets with Madoff. Plaintiffs allege that serving a demand upon Beacon Management to prosecute these claims would have been futile because Beacon Management and its principals were involved in the wrongdoing constituting the basis of the claims.

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' claim for breach of the administrative services agreement for failure to state a cause of action.

Finally, the court granted defendants' motion to dismiss based upon another action pending to the extent of staying the present action, pending resolution of related actions which were pending 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 purportedly brought as a class action on behalf of all Beacon investors, other than insiders such as Danziger and Markhoff. In the order of April 26, 2010, this court determined that the federal and state actions were sufficiently similar, even though plaintiff's precise claim against Beacon Management for breach of the operating agreement was not alleged in the federal complaint.

By order dated October 5, 2010, Judge Sand dismissed the derivative claims, except the claim for auditor negligence, on the ground that the claims were preempted by the Martin Act. Thus, 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.

Plaintiffs move to lift the stay on the ground that the federal action is no longer similar to the present action. As additional grounds for lifting the stay, plaintiffs assert that U.S. Magistrate Andrew Peck directed that discovery be coordinated with respect to the federal and state actions.

Defendant Ivy cross-moves to for leave to renew its motion to dismiss the complaint on the ground that plaintiffs no longer have standing to pursue a derivative action because Beacon is pursuing its own claims. The court has been informed by Herrick Feinstein, which represents Beacon, that an investors committee has been formed to pursue Beacon's claims. In opposition, plaintiffs argue that the assertion of Beacon's counterclaims is collusive, despite the appointment of the investors committee.

Defendants Beacon Associates Management, Joel Danziger, and Harris Markhoff oppose plaintiff's motion to lift the stay. Alternatively, these defendants cross-move to dismiss the complaint, or more accurately, for leave to renew their motion to dismiss the complaint on the same grounds as asserted by Ivy.

Defendant Friedberg, Smith moves for leave to renew its motion to dismiss the complaint on the ground that Beacon is pursuing its own claims, even though no counterclaim is asserted against that defendant. Friedberg, Smith argues that under the business judgment rule, the investors committee has discretion to determine the parties as to whom the Beacon fund should pursue claims.

CPLR 3211(a)(4) provides that a party may move for judgment dismissing one or more causes of action asserted against him on the ground that there is another action pending between the same parties for the same cause of action in a court of any state or the United States. The court need not dismiss upon this ground but may make such order as justice requires (Id). A court has broad discretion as to the disposition of an action when another action is pending (***Simonetti v Larson***, 44 AD3d 1028 [2d Dept 2007]). New York courts generally follow the first-in-time rule, that, as a matter of comity, the court which has first taken jurisdiction is the one in which the matter has been determined (***L-3 Communications v Safenet***, 45 AD3d 1, 7 [1st Dept 2007]). However, this rule should not be applied in a mechanical way, and special circumstances may warrant deviation where, through the first action, a party has obtained some unjust or inequitable advantage (Id).

The reason that the claims in the present action are no longer similar to those in the federal case is that the pendent derivative claims in the federal action were dismissed by

Judge Sand. As a matter of comity, this court would ordinarily apply principles of preclusion to claims which were dismissed in a federal court judgment (***McLearn v Cowen & Co.***, 48 NY2d 696 [1979]). However, because this court had already ruled upon the issue of Martin Act preemption, with respect to four of plaintiffs' claims, the concern of comity with the federal court is somewhat attenuated. The justification for the doctrine of pendent jurisdiction "lies in considerations of judicial economy, convenience, and fairness to litigants; if these are not present a federal court should hesitate to exercise jurisdiction over state claims, even though bound to apply state law to them. Needless decisions of state law should be avoided both as a matter of comity and to promote justice between the parties, by procuring for them a surer-footed reading of applicable law" (***McLearn v Cowen & Co.***, **supra**, 48 NY2d 703 [Meyer, dissenting]).

Since this court had already denied defendants' motions to dismiss plaintiffs' breach of fiduciary duty, aiding and abetting, gross negligence, and auditor negligence claims on the ground of Martin Act preemption, Judge Sand's ruling with respect to Martin Act preemption was unnecessary as to those claims. To the extent that Judge Sand's ruling upon the issue of Martin Act preemption was unnecessary, this court declines to be bound by it.

Accordingly, plaintiffs' motion to lift the stay based upon subsequent proceedings in the federal court is **granted**. Defendants' motions for leave to renew their motions to dismiss the complaint is also **granted**.

The court notes that the counterclaims asserted by Beacon Associates sound in gross negligence as to Ivy and indemnity and fraud as against the other defendants. A shareholder lacks standing to bring a derivative action once the corporation elects to sue in its own right (**Silver v Chase Manhattan Bank**, 49 AD2d 851 [1st Dept 1975]). Accordingly, upon renewal, defendant Ivy's motion to dismiss plaintiffs' claim against Ivy for negligence for lack of capacity to sue is **granted**.

The business judgment rule bars judicial inquiry into actions of corporate directors taken in good faith and in the exercise of honest judgment in the lawful and legitimate furtherance of corporate purposes (***Consumers Union v New York***, 5 NY3d 327 [2005]). Beacon Associates offers no explanation for its failure to pursue the breach of contract claim against Beacon Management, or the breach of fiduciary duty, or auditor negligence claims. Thus, on this motion to dismiss, the court must assume that the decision of the investors committee not to pursue those claims was not made in the exercise of honest judgment and

in good faith. Defendants' motion to dismiss the breach of contract claim against Beacon Management, the breach of fiduciary duty, aiding and abetting, and auditor negligence claims for lack of capacity is **denied**.

Defendants' motion to dismiss plaintiffs' claims for breach of fiduciary duty against Beacon Associates Management, plaintiffs' claims for aiding and abetting against Danziger, Markhoff, and Ivy, and plaintiffs' claims against Friedberg, Smith based on Martin Act preemption are **denied** based upon law of the case.

Although Ivy did not argue before this court that plaintiffs' claims for breach of the1995 administrative services agreement and the 2006 consulting agreement were preempted by the Martin Act, that argument was made and accepted by Judge Sand. Accordingly, defendant Ivy's motion to dismiss plaintiffs' claims for breach of the 2006 consulting agreement based on Martin Act preemption is **granted**. Defendants' motion to dismiss plaintiffs' claim for breach of the 1995 administrative services agreement was previously **granted** by the court.

As noted, plaintiffs' claim against Beacon Management for breach of the operating agreement is not asserted in the federal complaint. Thus, there is no concern with deference to Judge Sand's ruling on the issue of Martin Act preemption. With respect to plaintiff's claim against Beacon Management for breach of fiduciary duty, this court reasoned that defendant failed to exercise diligence and prudence, not with respect to investment recommendations, but in the management of Beacon Associates' assets. Thus, plaintiffs' claim against Beacon Management for breach of the operating agreement does not arise from securities fraud and is not preempted by the Martin Act. Accordingly, defendant Beacon Management's motion to dismiss plaintiffs' claim for breach of the operating agreement based on Martin Act preemption is **denied**. In summary, defendants' motions to dismiss plaintiffs' first, second, and fourth causes of action are **granted**. Defendants' motions to dismiss plaintiffs' third, fifth, sixth, seventh, eighth, and ninth causes of action are **denied**.

So ordered.

Dated AUG 11 2011

Stephen A. Bucaria
J.S.C.