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**Hearing Date:**  
**September 25, 2008**  
**10:00 A.M.**

**UNITED STATES BANKRUPTCY COURT**  
**SOUTHERN DISTRICT OF NEW YORK**

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**In re:**

**CHAPTER 7**

**KOLLEL MATEH EFRAIM, LLC, a/k/a**  
**MATEH EPHRAIM, LLC, a/k/a KOLEL**  
**MATEH EFRAIM,**

**CASE NO. 04-16410 (SMB)**

**Debtor.**

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**ROBERT L. GELTZER, as Chapter 7**  
**Trustee of the Estate of Debtor KOLLEL MATEH**  
**EFRAIM, LLC, a/k/a MATEH EPHRAIM LLC,**  
**a/k/a KOLEL MATEH EFRAIM,**

**ADV. PROC. NO. 08-01265 (SMB)**

**Plaintiff,**

**-against-**

**JACK LEFKOWITZ and ABRAHAM**  
**STEINWURZEL,**

**Defendants.**

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**DEFENDANTS' REPLY MEMORANDUM OF LAW IN FURTHER**  
**SUPPORT OF THEIR MOTION TO DISMISS THE TRUSTEE'S COMPLAINT**

### **Preliminary Statement**

Defendants Jack Lefkowitz (“Lefkowitz”) and Abraham Steinwurz ( “Steinwurz”) submit this Reply Memorandum of Law in further support of their Motion for an Order pursuant to Bankruptcy Rule 7012(b)(6), dismissing the Complaint for failure to state a cause of action and for lack of capacity and standing on the part of the Trustee.

In our Initial Memorandum, we demonstrated that based upon the allegations contained in the Complaint (as well as the provisions of the documents [the Contract of Sale and the Occupancy Agreement] incorporated into and relied upon in the Complaint), the Trustee’s “breach of fiduciary duty” claims against the defendants were dismissible as a matter of law for three separate and independently dispositive reasons. Despite his thirty-one page Memorandum of Law in opposition to the Motion, the Trustee fails to adequately address the dispositive legal bases for the defendants’ Motion. And, to a large extent, the Trustee simply tries to “sweep under the rug” the defects in his pleading, which were pointed out in our Initial Memorandum.

### **ARGUMENT**

#### **Point I**

#### **The Trustee Lacks Standing to Maintain This Action**

The Trustee does not dispute the proposition that under New York law, where all of the shareholders of a company have participated in or subsequently ratified the alleged wrong, they (and the corporation) are estopped from thereafter challenging the subject transaction. Nor does the Trustee dispute the fundamental principle that his standing (whether under Section 541, 542 or 544 of the Code) is entirely “derivative”; *i.e.*, that “under the Bankruptcy Code the Trustee stands in the shoes of the bankrupt corporation and has standing to bring any suit that the

bankrupt corporation could have instituted' if it had not filed for bankruptcy protection." *In re Food Management Group LLC*, 308 B.R. 677, 691 (Bankr. S.D.N.Y. 2008), quoting *Shearson Lehman Hutton Inc. v. Wagoner*, 944 F.2d 114, 118 (2d Cir. 1991).

Nevertheless, the Trustee argues that *even though the Debtor could not have brought the subject breach of fiduciary duty claim against defendants* (who are alleged to be the sole manager and member of the Debtor), the Trustee may nevertheless maintain this Adversary Proceeding. The essence of the Trustee's position is (i) that the *Wagoner* rule does not apply "where the trustee's claim is asserted not against a third party, but against the debtor's fiduciaries themselves"; and (ii) that "the trustee has standing to bring his claim against defendants because defendants' wrongful *post-petition conduct* constitutes a breach of their fiduciary duties for which the Trustee has standing to recover on behalf of the debtor's estate." (Tr. Mem. at 20-22; emphasis supplied.)

The first argument is a complete red herring. Indeed, our Initial Memorandum specifically *acknowledges* that *Wagoner* does not apply to a trustee's actions against the fiduciaries of the debtor. (Def. Mem. at 5) However, *Wagoner's* inapplicability does not alter the purely derivative nature of the Trustee's standing to maintain a breach of fiduciary duty action against the defendants, which turns upon the substantive provisions (and limitations) of *state law*. In other words, to the extent that state law limits a breach of fiduciary duty claim, the Trustee is not relieved of those limitations merely because he has commenced an adversary proceeding in Bankruptcy Court.

Here, an integral part of the relevant “state law” is the principle laid down by the New York Court of Appeals in *Diamond v. Diamond*, 307 N.Y. 263 (1954) – that a shareholder who has himself participated in the alleged wrongful conduct may not thereafter maintain an action predicated upon the same acts. This principle applies with unique force where, as here, the alleged wrongdoers (defendants Lefkowitz and Steinwurz) are the sole alleged member and manager of the entity. Nor does the rule of *Diamond* – which is premised upon an estoppel theory – depend upon the *form* of the shareholder’s challenge to his own conduct; *i.e.*, whether the action is brought in his individual capacity, derivatively, or in the “direct name” of the entity. Significantly, none of the cases relied upon by the Trustee addressed the applicability of the *Diamond* rule; nor, with the exception of *In re Mediators Inc.*, 105 F. 3d 822 (2d Cir. 1997), discussed *infra*, did they concern an entity which was owned and managed *entirely* by the alleged wrongdoer.<sup>1</sup>

As noted in our Initial Memorandum, *Mediators* concerned a breach of fiduciary duty claim by a committee of unsecured creditors against a husband and wife who owned and operated the Debtor. In his decision, Judge Haight recognized that the trustee’s “ability to assert that claim in bankruptcy depends on whether the corporation, and not its creditors, could have brought it pre-petition.” The Court declined to dismiss the claim *only because* the Complaint

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<sup>1</sup> The Trustee’s attempt to draw a distinction between an action brought derivatively by the “participating shareholder” (which he concedes would be barred by *Diamond*) and an action brought by “the company itself” (Tr. Mem. at 21-22) is completely inconsistent with the Second Circuit’s decision in *Mediators*, where the Court approved of the “sole actor” exception to the “adverse interest” exception on the grounds that where the alleged wrongdoer “was the [entity’s] sole shareholder and decision maker . . . therefore whatever decisions he made were, by definition, authorized by, and made on behalf of, the corporation.” *Id.* at 827.

alleged that the debtor was insolvent at the time of the alleged breach, and in light of two Second Circuit decisions establishing that a director of an insolvent corporation owes a direct duty to the creditors. *See* Def. Mem. at 6-7. We pointed out that *no allegations* of “insolvency” appear in the Trustee’s Adversary Complaint; moreover, the entire theory of the adversary proceeding is that the defendants breached a fiduciary duty “owed to the debtor.” *Id.* at 7-8. Incredibly, nowhere in his thirty-one page answering Memorandum does the Trustee devote a single sentence to Judge Haight’s analysis in *Mediators* which, we respectfully submit, compels dismissal of the Trustee’s Adversary Complaint.<sup>2</sup>

The Trustee’s Complaint is also not saved by the “post-petition” nature of his breach of fiduciary duty claim. We do not quarrel with the general proposition that because a cause of action accruing after the filing of the petition constitutes “property of the estate” under Section 541(a)(1) and (7) of the Code, “a Chapter 7 trustee has standing to bring claims for post-petition breaches of fiduciary duties owed to the debtor in possession.” Tr. Mem. at 23. This, however, begs the question, because the Trustee’s standing to bring such claims is, as noted above, derivative and depends upon whether the debtor (in this case, Kolllel) would have been able to bring the breach of fiduciary claim in the absence of a bankruptcy petition. The determination of whether the claim “belongs” to the corporation or the creditors is a matter determined by state law. *Mediators, supra*, 105 F. 3d at 825; *Mixon v. Anderson*, 816 F. 2d 1222, 1225 (8<sup>th</sup> Cir. 1987).

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<sup>2</sup> There is no merit to the Trustee’s assertion that there is somehow an inconsistency between defendants’ invocation of *Diamond* and their avoidance of personal liability for the corporate obligations of the Debtor. Significantly, the Trustee cites no authority in support of this

That the Trustee has no standing in this case to bring a post-petition breach of fiduciary claim against the defendants is, we believe, confirmed by Judge Glenn's recent decision in *Food Management, supra*, cited by the Trustee in his Memorandum at 23. In *Food Management*, Judge Glenn noted that while "causes of action that arise after the debtor files for bankruptcy generally become property of the debtor's estate . . . 'to become part of the bankruptcy estate, a cause of action must belong to the debtor itself, either in whole or in part, and *cannot belong solely to the debtor's creditors or shareholder.*'" *Food Management, supra*, 380 B.R. at 692, quoting *In re Betty Owens School Inc.*, 1997 WL 188127 at \*2 n.1 (S.D.N.Y. 1997) (emphasis supplied). *Accord, Sender v. Simon*, 84 F. 3d 1299, 1305 (10<sup>th</sup> Cir. 1996) ("importantly, to satisfy the requirements of §541, the cause of action asserted must belong to the debtor entity itself, not the debtor's creditors individually").

The dispositive issue, in short, is *not*, as the Trustee would have it (Tr. Mem. at 23), whether *Wagoner* does or does not apply to "post-petition misconduct" (an issue which has, as Judge Glenn noted in *Food Management*, not been addressed or decided by the Second Circuit, *see* 380 B.R. at 697-99). Rather, it is whether the debtor, Kolllel, would be able to bring these breach of fiduciary duty claims against its sole manager and member. If the answer to this question is no (as it must be, in light of *Diamond*), then the Trustee cannot do so either. In this regard, it is of critical (indeed, dispositive) significance that the *only reason* the Complaint in *Mediators* was upheld was because of an alleged duty owed *directly to the creditors*. Here, even if such a duty could be found to have existed with respect to Kolllel's creditors, *Food*

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proposition.

*Management* confirms that it would not be sufficient to confer standing on the Trustee to sue for “post-petition” wrongs, which is limited to claims which could have been brought by the debtor itself.

## Point II

### Plaintiff Does Not Plead a Basis for Avoiding the Business Judgment Rule

For the reasons set forth in Point II of our Initial Memorandum, the Trustee fails to plead a basis for avoiding the protections afforded the defendants by the “business judgment rule.” While the Trustee repeatedly accuses the defendants of “bad faith”, he acknowledges that the Complaint does not allege any facts suggesting that either defendant converted any funds belonging to the Debtor. Indeed, the best the Trustee can do to show that either defendant “personally benefited” from the alleged “rent free” use of the Property by the Camp was that one of Lefkowitz’s sons spent a summer as a camper and that during one of the summers Steinwurzle and his family “enjoyed free room and board at the premises.” (Tr. Mem. at 14. n. 5)

As the Trustee implicitly acknowledges, this Court’s recent decision in *In re Global Service Group LLC*, 316 B.R. 451 (Bankr. S.D.N.Y. 2004) strongly supports dismissal of the Adversary Complaint here. In that case, the Court dismissed a breach of fiduciary duty claim brought against a number of “insider defendants”, noting that the Complaint failed to allege “that the Goldmans continued to operate the debtor as a means of siphoning the debtor’s funds for their individual benefit.” *Id.* at 465. Like the Complaint in *Global*, there are no substantive factual allegations in the Trustee’s Complaint that Steinwurzle and Lefkowitz “siphoned” any of Kollle’s funds “for their individual benefit.”

### Point III

#### **The Occupancy Agreement Precluded Kolllel, as Vendee in Possession From Leasing the Meadows Property**

In his Answering Memorandum, the Trustee does not dispute that the combined effect of the Occupancy Agreement and the Contract was to preclude the defendants from leasing the Meadows Property to a summer camp for profit. In an attempt to sidestep the logical consequence of this concession – that any damage claim premised upon an alleged *failure to lease the Meadows Property to a summer camp for profit* must therefore fail – the Trustee argues that defendants somehow are precluded from relying upon this logical and legal flaw on the purported grounds that “by allowing for the operation of a camp without permission from Helen-May, [they] breached the very same provisions in the Occupancy Agreement and Contract.” Tr. Mem. at 27.

Respectfully, we fail entirely to understand that Trustee’s argument. For one thing, there is a world of difference under the Occupancy Agreement and the Contract between permitting use of the Property on a not-for-profit basis and leasing the Property for rental payments. More fundamentally, we are aware of no principle of law – and the Trustee certainly cites none – which permits a plaintiff to base a breach of fiduciary duty claim on the premise that the corporate officers were *obligated to violate* the corporation’s contract with a third party in order to maximize corporate revenues. Yet, this is *precisely* the “damage theory” propounded by the Trustee.

Two more points. The Trustee states in his Memorandum that as an alternative to the summer camp, the Property could have been rented as a hotel. This is, however, not the theory of

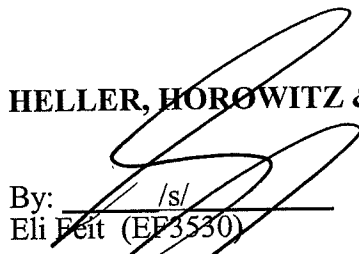
damages contained in the Complaint, which is limited to the alleged wrongful failure of the defendants to obtain rental payments *with respect to the summer camp*. Second, the Trustee says (again in his Memorandum) that the defendants committed waste by failing to surrender occupancy of the Property, and thereby avoiding the claims of the Landlord. However, the defendants' decision to "hold on" to the Property (and thereby "keep their options open") is a matter which is clearly covered by the business judgment rule; it was far from clear during the period 2004 through 2007 that Kolliel would not be able to close on the purchase contract.

### CONCLUSION

For the foregoing reasons, as well as the reasons set forth in defendants Initial Memorandum, defendants respectfully request that this Court grant their motion to dismiss the Trustee's Adversary Complaint.

Dated: New York, New York  
September 16, 2008

**HELLER, HOROWITZ & FEIT, P.C.**

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