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

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RKA Film Financing, LLC, **Index No. 652481/2015**

Plaintiff,

-against-

Ryan Kavanaugh and,
River Birch Funds LLC,

Defendants.

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MEMORANDUM OF LAW IN SUPPORT OF RYAN KAVANAUGH AND RIVER BIRCH FUNDS LLC'S MOTION TO DISMISS COMPLAINT AND FOR SANCTIONS

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Attorneys for Defendants Ryan Kavanaugh and River Birch Funds LLC

Defendants Ryan Kavanaugh and River Birch Funds LLC ("River Birch") (together, the "Defendants") submit this Memorandum of Law in Support of their Motion to Dismiss the Verified Complaint pursuant to CPLR § 3211(a)(1) based on documentary evidence, Section 3211(a)(7) for failure to state a claim, Section 3211(a)(3) for lack of legal capacity to sue, and also in support of their request for sanctions.

PRELIMINARY STATEMENT

RKA Film Financing, LLC ("RKA") commenced this action with a press release masquerading as a Complaint. Ignoring the plain language of the agreements between it and River Birch and its own governing documents, RKA has launched a wholly unjustified attack on River Birch and its managing member, Mr. Kavanaugh. Indeed, the facts and circumstances of this lawsuit demonstrate that RKA is abusing the litigation process for ulterior motives. Most blatantly, RKA added Mr. Kavanaugh as a defendant solely to generate media interest in an otherwise commonplace commercial dispute between RKA and River Birch. RKA does not sue Mr. Kavanaugh on the basis of any agreement with him and does not even bother to assert a legal basis for liability against Mr. Kavanaugh. And, as to River Birch, RKA ignores the clear requirements of its agreement with River Birch and fails to seek the sole remedy available to it, choosing instead to launch an unauthorized and improper lawsuit.

RKA has ignored express requirements in its LLC Agreement governing the retention of legal counsel. Contrary to Latham & Watkin's implicit representation to the Court that it has the proper authority to bring this lawsuit, its putative appearance on behalf of RKA is in violation of RKA's LLC Agreement, as Latham & Watkins, itself, has acknowledged to River Birch, and if RKA and its attorneys had obeyed the LLC Agreement's clear provisions, this lawsuit never could have been brought.

In light of RKA's abuse of the litigation process in bringing baseless and malicious claims against Mr. Kavanaugh and River Birch, this lawsuit should be dismissed, and RKA should be sanctioned.

STATEMENT OF FACTS

RKA is a limited liability company, formed on June 26, 2014. It provides financing to other entities and extended loans to special purpose entities (the "Designated SPEs") affiliated with Relativity Media, LLC ("Relativity"), a film studio founded by Mr. Kavanaugh. (Compl. ¶¶ 1-2.) On or about June 5, 2015, RKA and Relativity entered into multiple agreements, including a Letter Agreement and Limited Release Agreement. (Compl. ¶ 3.) Under Sections 2(C)(i) and (ii) of the Limited Release Agreement, certain entities affiliated with Relativity agreed to transfer a total of $7.5 million—$3.5 million for each of two Pre-Release Loans outstanding for two unreleased films—to RKA's Agent by June 29, 2015. River Birch and RKA also entered into a Limited Guaranty and Unit Pledge Agreement (the "Guaranty and Pledge Agreement"). (Id.) In the Event of Default by Relativity, RKA would be entitled to receive from River Birch all payment and performance of the obligations under Sections 2(C)(i) and (ii) of the Side Letter Release. (Compl. ¶ 6.) The Guaranty and Pledge Agreement further provided that "upon the occurrence and continuation of an Event of Default, Secured Party shall exercise any and all rights, powers options and remedies provided herein under the UCC" including the ability to "foreclose the liens created hereunder." (Compl. Ex. C, § 6.1.)

RKA's putative counsel initiated correspondence with counsel for Relativity, after RKA raised concerns about Relativity's performance under the Limited Release Agreement. In that letter, RKA's putative counsel claimed to be unaware of the fact that Mr. Kavanaugh was represented by K&L Gates in this matter, and threatened legal action against Mr. Kavanaugh.

(See July 13, 2015 Letter from Scott Waxman, attached to the Affirmation of Joanna Diakos Kordalis ("Kordalis Affirmation") as Exhibit 1.) Upon learning of the threatened legal action, Mr. Kavanaugh and River Birch informed RKA, through Latham & Watkins, that the retention of counsel by RKA required unanimous approval of all Board Managers, as required by RKA's LLC Agreement. (Id.; see also Compl. Ex. A, § 5.1.(c)(v)) (setting forth specific matters that "shall require the unanimous consent of all Board Managers," including the "[a]ppointing, hiring or terminating . . . professional advisors by the Company . . . ."). Latham & Watkins responded stating that it was not aware of any objection to its retention by RKA managers, but not disputing that its retention was not approved by all Board Members. (See July 14, 2015 Letter from Benjamin Naftalis, attached to Kordalis Affirmation as Exhibit 2.) In fact, as is clear from Mr. Naftalis's letter, one of the RKA managers was apparently not even notified of the purported retention of Latham & Watkins, because Latham & Watkins did not have his e-mail address. Nevertheless, on July 15, 2015, RKA filed this action against Mr. Kavanaugh, in his personal capacity, and RKA member River Birch seeking River Birch's interest in RKA (the "RKA Equity Interest"). (Compl. ¶ 21.)

ARGUMENT

I. The Complaint Improperly Names Mr. Kavanaugh As A Defendant

The Complaint fails to address a critical fact that, on its own, is fatal to RKA's claims against Mr. Kavanaugh: he is not a party to the Guaranty and Pledge Agreement. Mr. Kavanaugh's sole connection to this dispute is that he is a member of River Birch, which in turn is a member of RKA. It is black letter law that members of limited liability companies are not liable for the obligations of the LLC itself. Indeed, the primary purpose of a limited liability company is to *limit the liability of its members*.

Under New York choice of law rules, Delaware, the state of formation, determines whether liability is imposed on members or shareholders. See Tapps of Nassau Supermarkets, Inc. v. Linden Boulevard L.P., 242 A.D.2d 235, 661 N.Y.S.2d 223 (1997) (applying Delaware partnership law to determine liability of general and limited partners). An LLC is a separate legal entity distinct from its members. 6 Del. C. § 18-201(b). Members in an LLC, like shareholders in a corporation, have limited liability. Id. at §§ 18-303.[1]

Section 18-303(a) of the Delaware Limited Liability Company Act provides that no member of an LLC shall be personally liable for the LLC's debt solely by reason of being a member:

> Except as otherwise provided by this chapter, the debts, obligations and liabilities of a limited liability company, whether arising in contract, tort, or otherwise, shall be solely the debts, obligations and liabilities of the limited liability company, and no member or manager of a limited liability company shall be obligated personally for any such debt, obligation or liability of the limited liability company solely by reason of being a member or acting as a manager of the limited liability company.

In accordance with the plain language of the statute, the debts, obligations, and liabilities of River Birch "shall be solely the debts, obligations and liabilities" of River Birch. It is also clear under Delaware law that Mr. Kavanaugh, a member of River Birch, shall not be "obligated

[1] New York law is in accord. Section 609(a) of New York Limited Liability Company Law provides:

> Neither a member of a limited liability company, a manager of a limited liability company managed by a manager or managers nor an agent of a limited liability company (including a person having more than one such capacity) is liable for any debts, obligations or liabilities of the limited liability company or each other, whether arising in tort, contract or otherwise, solely by reason of being such member, manager or agent or acting (or omitting to act) in such capacities or participating (as an employee, consultant, contractor or otherwise) in the conduct of the business of the limited liability company.

Section 610 of the New York LLC Law further provides, "[a] member of a limited liability company is not a proper party to proceedings by or against a limited liability company, except where the object is to enforce a member's right against or liability to the limited liability company." See also 450 W. 14th St. Corp. v. 40-56 Tenth Ave. LLC, 724 N.Y.S.2d 273 (2001) ("a member of a company organized under [the limited liability company] law is not a proper party to an action against the company").

personally for any such debt, obligation or liability" of River Birch. There is absolutely no basis for holding Mr. Kavanaugh liable for any alleged obligations of River Birch.

This proposition is so fundamental that it reveals the real purpose of the Complaint—to attract publicity to this action. Knowing that such notoriety would not attach itself to a complaint naming only River Birch, RKA ignored black letter law and named Mr. Kavanaugh without a single allegation that Mr. Kavanaugh was party to the very agreement it is attempting to enforce against him in his personal capacity, or that he could properly be, for any reason, held personally liable for the debts of River Birch.

RKA attempts to obfuscate the matter by gratuitously annexing Mr. Kavanaugh's name to every description in the Compliant of an agreement between RKA and River Birch. See Compl. ¶ 6 (quoting the Guaranty and Pledge Agreement to state that "upon an Event of Default, River Birch (*i.e.* Kavanaugh) shall immediately transfer its entire equity interest in RKA"). No such parenthetical or *id est* exists. RKA also describes the collateral as the "Kavanaugh RKA Equity Interest." Id. But, contrary to that misleading phrase, RKA has no security interest in Mr. Kavanaugh's personal property. In reality, the Guaranty and Pledge Agreement defines the equity interest collateral as "all of the issued and outstanding Class B Units of the Secured Party owned by *Guarantor*." See Guaranty and Pledge Agreement § 1.1 (emphasis added). And the Guarantor is *only* "River Birch Funds LLC." Id. The Complaint then continually alleges that "Mr. Kavanaugh and River Birch" breached the Guaranty and Pledge Agreement and are therefore liable—without stating a single fact showing that Mr. Kavanaugh should be liable in his personal capacity for any putative breach by River Birch.

Mr. Kavanaugh is not, in sum, a proper party to this suit. He was not a party to the Guaranty and Pledge Agreement RKA is purportedly seeking to enforce in this action. Any

liabilities for alleged breach of that Agreement are solely those of River Birch. The law does not impose—and RKA does not even attempt to allege—personal liability on Mr. Kavanaugh's behalf solely by virtue of his membership in River Birch. Accordingly, Mr. Kavanaugh should be dismissed with prejudice from this lawsuit. Rabos v. R&R Bagels & Bakery, Inc., 100 A.D.3d 849, 850, 955 N.Y.S.2d 109, 112 (2012) (stating that a motion to dismiss pursuant to CPLR 3211 (a)(1) may be appropriately granted "where the documentary evidence utterly refutes plaintiff's factual allegations, conclusively establishing a defense as a matter of law"); Lovisa Const. Co. v. Metro. Transp. Auth., 198 A.D.2d 333, 333, 603 N.Y.S.2d 886, 886 (1993) (affirming grant of motion to dismiss because claims were "flatly contradicted by documentary evidence").

II. RKA Is Required To Comply With The Foreclosure Procedures Of The UCC

Aside from seeking to garner media attention, RKA's Complaint ostensibly seeks to obtain all RKA Equity Interest shares. Even were RKA entitled to the shares on the date of filing, the current action in Supreme Court of the State of New York is the improper vehicle and forum to seek such a remedy.

As Section 6.1 of the Guaranty and Pledge Agreement states, "upon the occurrence and continuation of an Event of Default, Secured Party shall exercise any and all rights, powers options and remedies provided herein under the UCC" including the ability to "foreclose the liens created hereunder." As proscribed by the Guaranty and Pledge Agreement, New York's Uniform Commercial Code (the "UCC") applies. See Guaranty and Pledge Agreement § 7.5. Under Sections 9-620 and 9-610 of the UCC, a secured party may become the owner of collateral previously owned by a debtor by either strict foreclosure or sale of the collateral. N.Y. U.C.C. §§ 9-620, 9-610. Therefore, in order to take ownership of the RKA Equity Interest, RKA

must foreclose on that security interest through one of those two statutorily prescribed processes. See also N.Y. U.C.C. § 9-625(a) (authorizing *debtors* to seek, and a court to grant, injunctive relief *against a secured party* if the "secured party is not proceeding in accordance with *this article*") (emphasis added); S. M. Flickinger Co. v. 18 Genesee Corp., 71 A.D.2d 382, 384, 423 N.Y.S.2d 73, 75 (1979) (holding that when a secured creditor exercises its rights and remedies in the event of default "it *must* conform to the requirements Article 9") (emphasis added).

RKA has not, however, either foreclosed on the collateral or sold it. Instead, RKA brings this lawsuit to request a declaratory judgment that "the Kavanaugh RKA Equity Interest rightfully belongs to RKA." (Compl. ¶ 21(d).) In so doing, RKA seeks to circumvent the proscribed safeguards in the UCC that River Birch negotiated and obtained in the Guaranty and Pledge Agreement. Count II of the Complaint therefore should be dismissed with prejudice.

III. Latham & Watkins Was Not Authorized By RKA To Bring This Action

Not only is this action brought against an improper party, and seeking remedies through improper means, it is also brought by improperly retained counsel. Under Section 5.1(c)(v) of the RKA LLC Agreement, the "appointing, hiring or terminating . . . [of] professional advisors by the Company . . . ." requires unanimous consent of all Board Managers. (See Compl. Ex. A, § 5.1(c)(v).) At the time the Complaint was filed, Plaintiff's counsel had not been approved by unanimous consent of all Board Members and therefore cannot purport to represent RKA in this lawsuit or in any other capacity. See Kordalis Aff., Ex. 2 (stating that the engagement of Latham & Watkins "required no board consent" and that Latham is "aware of no objection" by the managers of RKA related to the retention of Latham, and acknowledging that one manager did not even have notice); see also Schillinger & Albert Inc. v. Myral Hats Inc., 55 Misc. 2d 178, 179, 284 N.Y.S.2d 780, 781 (Civ. Ct. 1967) (granting defendant's motion to dismiss on the

ground that the corporate plaintiff did not authorize the institution or prosecution of an action to recover corporate funds); P.B.G. Realty, Inc. v. Putter, 41 Misc. 2d 129, 245 N.Y.S.2d 45 (Sup. Ct. 1963) ("[i]t is clear that no authority was given . . . to institute this action on behalf of the corporation by the promoters who constitute, at least, the de facto officers and directors of the corporation. Accordingly, it appears clear that this action cannot be prosecuted . . . ."); Kardwheel Corp. v. Karper, 1 Misc. 2d 707, 148 N.Y.S.2d 132 (Sup. Ct. 1956) (granting motion to strike out the appearance of attorneys for plaintiff corporation on the ground that the corporation had not authorized the suit).

The facts here are substantially similar to Feeley v. NHAOCG, LLC, 2012 WL 4859157 (Del. Ch. Oct. 12, 2012). In Feeley, the court held that a member's purported removal of the managing member of Oculus Capital Group, LLC ("Oculus") was unauthorized and void because the member had no authority to do so unilaterally under the limited liability company agreement of Oculus (the "Oculus Agreement"). To remove the managing member, the unanimous consent of the members was needed. Because a unanimous consent was not obtained, the court held that the removal was unauthorized and void.[2]

As in Feeley, the President of RKA tried to hire Latham & Watkins unilaterally. But the RKA LLC Agreement did not give the President the authority to do so. (See Compl. Ex. A, § 5.1(c)(v).) Latham & Watkins are professional advisors and, by Latham & Watkins's own admission in an email from attorney Matthew Salerno, dated June 10, 2015, had not even contacted (let alone obtained the consent of) all of the members of the RKA Board of Managers regarding their purported retention. As such, RKA's purported hiring of Latham & Watkins, similar to the removal of the managing member in Feeley, was unauthorized and is void.

[2] The Delaware Court of Chancery also found that the member's removal of the President and CEO of Oculus was void because only the managing member had authority to do so under the Oculus Agreement.

By filing this action on behalf of RKA without proper approval, Plaintiff's counsel has misrepresented to the Court that it was properly engaged by RKA. This action should be dismissed.

IV. The Court Should Sanction RKA For Initiating The Frivolous And Improper Complaint

As stated above, the entirety of this litigation is without merit and improperly before the Court. Even read in the light most favorable to Plaintiff and its counsel, the Complaint remains "frivolous" as defined in 22 N.Y.C.R.R. § 130-1.1(c)(1): "it is completely without merit in law and cannot be supported by a reasonable argument for an extension, modification or reversal of existing law," "is undertaken primarily to . . . harass or maliciously injure another," or "asserts material factual statements that are false." RKA's Complaint is the rare trifecta. Section 130-1.1(a) empowers this Court, "as appropriate, to award any party" "reimbursement for actual expenses reasonably incurred and reasonable attorney's fees" and/or to impose a financial sanction against a party who engages in frivolous conduct. Id. at § 130-1.1(a). River Birch and Mr. Kavanaugh respectfully submit that such an award is warranted here. RKA has named Mr. Kavanaugh solely to generate salacious headlines without a single allegation that would warrant naming him as party; ignored the clear provisions of the Guaranty and Pledge Agreement in an attempt to enforce its purported rights through means that are in direct conflict with that agreement; and has ignored its own LLC Agreement to improperly retain counsel to prosecute this action. In return, Defendants request an amount to be determined for Defendants' legal fees and costs in responding to RKA's Complaint.

Section 103-1 allows a court to exercise discretion, taking into account "whether the conduct was continued when it became apparent, or should have been apparent that the conduct was frivolous." Levy v. Carol Mgmt. Corp., 260 A.D.2d 27, 34, 698 N.Y.S.2d 226, 233 (1999);

Lusker v. 85-87 Mercer St. Assoc., 272 A.D.2d 278, 709 N.Y.S.2d 398 (2000) (upholding sanctions for violations of CPLR 3012(b)); IndyMac Fed. Bank v. Meisels, 37 Misc. 3d 1206(A), 961 N.Y.S.2D 358 (Sup. Ct. 2012) (ordering sanctions hearing where plaintiff brought frivolous action). RKA was put on notice of the lack of contractual and statutory basis for filing suit against Mr. Kavanaugh individually, the deficiencies in its engagement with RKA, and that Mr. Kavanaugh would seek sanctions from the court for the filing of a frivolous and baseless suit against Mr. Kavanaugh. See Kordalis Aff., Ex. 1. Without arguing that Mr. Kavanaugh is in fact personally liable, prior to or in the body of the Complaint, ignoring the clear terms of the Guaranty and Pledge Agreement, and plainly admitting that the retention of Latham & Watkins had not been approved by unanimous board consent, RKA nonetheless filed this action with full knowledge of its blatant and abundant deficiencies.

CONCLUSION

For the foregoing reasons, Defendants respectfully request that Plaintiff's Complaint be dismissed with prejudice and in its entirety, or, at a minimum, that it be dismissed with prejudice and in its entirety as to Ryan Kavanaugh, and that sanctions be awarded in favor of Mr. Kavanaugh and River Birch.

Dated: August 4, 2015
New York, New York

Respectfully submitted,

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