To Be Argued By:
E. LEO MILONAS
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Court of Appeals

STATE OF NEW YORK

STEVE PAPPAS and CONSTANTINE INFANTOPOULOS,

Plaintiffs-Respondents,

- *against* –

STEVE TZOLIS,

Defendant-Appellant,

- *and* –

VRAHOS LLC,

Defendant.

BRIEF FOR DEFENDANT-APPELLANT

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Defendant-Appellant Steve Tzolis respectfully submits this Brief in support of his appeal from the Decision and Order of the Appellate Division, First Department, entered on September 15, 2011.

QUESTIONS PRESENTED

1. Did the Appellate Division err in holding that, in a buyout of two members' interests in an LLC by the third member, the buyer had "overriding" fiduciary duties even where the sellers executed a certificate declaring that the buyer "has no fiduciary duty" to them and where the LLC's Operating Agreement was inconsistent with a fiduciary relationship among the members?

Answer: The Appellate Division erred. At the closing of the challenged buyout, the parties expressly agreed in writing that the buyer "ha[d] no fiduciary duty" to the sellers. Record on Appeal ("R.") 126. Both New York and Delaware law permit such a disclaimer. Moreover, the LLC's Operating Agreement did not establish a traditional fiduciary relationship. Instead, it allowed each member to "engage in business ventures and investments *of any nature whatsoever*, whether or not in competition with the LLC, *without obligation of any kind* to the LLC or to the other Members." R.85 ¶11 (emphasis added). *See* Point I.

2. Did the Appellate Division err in holding that, in a buyout of two members' interests in an LLC by the third member, because the buyer allegedly did not disclose negotiations with a subsequent purchaser, the buyout was not

"willing[] or at arm's length" and thus could support claims for conversion and unjust enrichment?

Answer: The Appellate Division erred. In the buyout, the parties reaffirmed that they dealt at arm's length by executing a certificate stating that the purchaser "ha[d] no fiduciary duty" and that the sellers had "engaged [their] own legal counsel" and were "not relying on any representation" by the purchaser. R.126. Because the buyout was conducted at arm's length, even if there had been negotiations with a subsequent buyer, the purchaser had no duty to disclose them. The buyout was of course "willing" because it was a consensual business transaction. Under those circumstances, neither conversion nor unjust enrichment may be alleged. *See* Points II-III.

3. Did the Appellate Division err in holding that, in a buyout of two members' interests in an LLC by the third member, the sellers could maintain a claim for fraud and misrepresentation after executing a certificate declaring that they were "not relying on any representation" by the buyer?

Answer: The Appellate Division erred. At the closing of the buyout, the parties expressly agreed in writing that the sellers were "not relying on any representation" by the purchaser. R.126. Under New York law, such a specific disclaimer bars a claim for misrepresentation. Additionally, under the LLC's

Operating Agreement, the members had no duty to disclose their business ventures to each other. *See* Point IV.

4. Was the order of the Appellate Division, which modified in part and otherwise affirmed the order of the Supreme Court, properly made?

Answer: The Appellate Division's Order was erroneous. For the reasons stated herein, the Order should be reversed insofar as it reinstated Plaintiffs' First, Fourth, Fifth and Tenth Causes of Action, and those causes of action should be dismissed.

STATEMENT OF JURISDICTION

From an Order of Supreme Court, New York County (Ira Gammerman, J.H.O.) entered on or about March 4, 2010, which dismissed the complaint in its entirety on the motion of Defendant-Appellant Steve Tzolis ("Tzolis"), Plaintiffs-Respondents Steve Pappas ("Pappas") and Constantine Infantopoulos ("Infantopoulos") (together, "Plaintiffs") appealed to the Appellate Division, First Department. *See* R.36, 45. In a 3-2 decision, by Order entered on September 15, 2011 (as to which Notice of Entry was served by mail on September 17, 2011), the Appellate Division modified Supreme Court's Order to deny Tzolis's motion to dismiss as to the first, fourth, fifth and tenth causes of action. *See* R.4-31. Tzolis timely moved in the Appellate Division for leave to appeal to this Court pursuant

to CPLR §5602(b)(1). The Appellate Division granted Tzolis's motion for leave to appeal by Order dated January 19, 2012. R.3.

STATEMENT OF FACTS

A. The Parties' Business Dealings

In 2006, Tzolis, Pappas and Infantopoulos entered into an agreement (the "Operating Agreement") that formed Vrahos LLC, a Delaware limited liability company (the "LLC"). R.77-89. Tzolis and Pappas each made an initial capital contribution of $50,000, and Infantopoulos made an initial contribution of $25,000. R.80-81. Consistent with their initial contributions, Pappas and Tzolis each owned 40 percent of the LLC, and Infantopoulos owned 20 percent. R.83 ¶8.3(c).

All three members of the LLC were designated as "Managers." R.84 ¶10.1. All decisions in the LLC's governance had to be unanimous, with no single member having authority to act on the LLC's behalf. *Id*. Thus, all three members had equal rights in management of the LLC. The Operating Agreement contained "the entire agreement of the members." R.88 ¶20.2.

The Operating Agreement eliminated the fiduciary duties that ordinarily would be owed by the owners of a closely-held corporation. Specifically, Paragraph 11 of the Operating Agreement provided:

> Any Member may engage in business ventures and investments *of any nature whatsoever, whether or not in competition with the LLC, without obligation of any kind* to the LLC or to the other Members.

R.85 ¶11 (emphasis added).

As contemplated in the Operating Agreement (R.77 ¶4(a)), on January 13, 2006, the LLC entered into a long-term lease of a building at 68-74 Charlton Street in Manhattan (the "Lease") from the building's owner, 68 & 74 Charlton Street Company, LLC (the "Landlord"). R.139-217. The Lease's initial term was approximately 30 years and six months, subject to renewal for additional terms of up to 18 years and six months, for a total of 49 years. R.142-143. Among other things, the Lease required (i) improvements costing at least $1 million, and (ii) a security deposit of $1,192,500. R.77; R.142-143. The Lease was the LLC's sole asset. *See* R.6-7. Tzolis and Pappas both signed a Guaranty, which obligated them each individually to pay up to $2,000,000 of rent, taxes, insurance, interest and other charges plus additional accrued and unpaid amounts under the Lease. R.218-221 ¶¶1, 9.

The Operating Agreement required Tzolis to post and maintain the entire $1,192,500 security deposit. R.79 ¶5; R.132 ¶15.C(i); R.143. In consideration of his discharging that responsibility, the LLC granted Tzolis the "right to sublet" the building "on the same terms and conditions as the Lease." R.79 ¶4(d). The LLC turned over possession of the property to Tzolis. R.132 ¶15(C)(iii) (stating that Tzolis "he had taken possession of the Building and was using it"); R.130 ¶¶12-13. On June 16, 2006, the property was subleased (the "Sublease") to a Tzolis-owned

company, 108 Realty of N.Y. Corp. ("108 Realty"), for about $20,000 per month plus performance of the obligations under the Lease. R.133 ¶17; *see* R.93 ¶1.10.[1] Thus, after the Sublease took effect, the LLC's assets consisted of a fixed right to collect about $20,000 per month from 108 Realty. *See* R.133 ¶17. Tzolis guaranteed 108 Realty's payment of this amount under the same terms as in the original Lease. R.104. Tzolis also agreed to arrange for Pappas to be released from his obligations under the Guaranty. *Id.*

B. The Parties' Business Disputes

Pappas contends that the parties had numerous business disputes. Pappas claims that he "wanted to sublease the Building to other possible subtenants" (R.132 ¶16), and accuses Tzolis of not cooperating with his efforts to develop the property (R.133 ¶16). The parties also had disputes over whether Tzolis's initial capital contribution had been made, whether other subtenants should be found, whether the property should be listed for sale or lease with brokers, whether the current tenant should be retained, and whether 108 Realty was current in its payments on the sublease. R.132-134 ¶15.C(iii), 16, 19-20; *accord* 52-53 ¶9A, 9E.

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[1] The calculation is based on the building's 60,000 square foot size at the time of the Lease and the stated rate of $4.00 per square foot ($240,000), paid in monthly installments of $20,000. See R.93 ¶1.10. Beginning in 2011, the exact rent under the Sublease could change by the lesser of 2% per annum and any increase in the Consumer Price Index. *Id.* 108 Realty and/or Tzolis also undertook to pay certain expenses in connection with the formation of the LLC. *See* R.96 ¶3.2..

C. The Buyout

Ultimately, the disputes among the LLC's members were resolved through a buyout. On January 18, 2007, only one year after the execution of the Lease, Tzolis bought out the membership interests of Pappas and Infantopoulos. R.116-120; R.121-125. The value of the buyout totaled $1.5 million: $1 million for Pappas and $500,000 for Infantopoulos. *See* R.65 ¶63(b)(v); R.116; R.134 ¶21. This amount was 20 times what each of the Plaintiffs had invested one year earlier. *Compare* R.80-81 ¶6.1.

The buyout agreements set a deadline of February 5, 2007 on the transaction. R.118; R.123. By agreement, however, that date was extended. Specifically, an Estoppel Agreement signed by all parties provided:

> Extension of 2/5/07 Deadline. Each Assignor and the Assignee agree that "March 12, 2007" shall be deemed to be substituted for such "February 5, 2007" date, so that each Assignment shall be deemed to be amended to provide that if the "Effective Date" of such Assignment has not occurred by March 12, 2007, then, and only then, shall such Assignment "be void and of no effect."

R.223. Because the assignment of all LLC membership interests closed prior to March 12, 2007, it was effective. R.8-9; R.57 ¶20-23.

At the closing for the buyout, all parties executed a certificate (the "Certificate"), which stated in pertinent part as follows:

> Each of the undersigned sellers (Steve Pappas & Constantine Infantopoulos) agrees with & represents to

> STEVE TZOLIS that each of the undersigned Sellers, in connection with their respective assignments to Steve Tzolis of their membership interests in Vrahos LLC, has performed their own due diligence in connection with such assignments. ***Each of the undersigned Sellers*** has ***engaged its own legal counsel***, and ***is not relying on any representation by Steve Tzolis*** or any of his agents or representatives, except as set forth in the assignments & other documents delivered to the undersigned Sellers today. Further, ***each of the undersigned Sellers agrees that Steve Tzolis has no fiduciary duty to the undersigned Sellers in connection with such assignments***.

R.126 (emphasis added). The Certificate also contained reciprocal representations by Tzolis to the Plaintiffs:

> In addition, Steve Tzolis likewise agrees that he has performed his own due diligence in connection with such assignments, and Steve Tzolis is not relying on any representation by any Seller or any of the Seller's agents or representatives, except as set forth in the assignments & other documents delivered to Steve Tzolis today. ***Further, Steve Tzolis agrees that each of the undersigned Sellers has no fiduciary duty to Steve Tzolis in connection with such assignments***.

R.126.

As a result of purchasing all outstanding membership interests, Tzolis owned 100% of the LLC's membership interests. *See* R.134 ¶21. Tzolis also obtained the Landlord's release of Pappas's obligations under the Guaranty. R.57 ¶21; *see* R.118 ¶9(1).

On or about August 28, 2007, the LLC – now owned entirely by Tzolis – assigned the Lease with the LLC's Landlord to a developer, nonparty Extell, for $17.5 million. R.58 ¶25; R.225.

D. The Lawsuit

After the Lease was assigned to Extell, Pappas and Infantopolous sued Tzolis. R.49-75. Based on unspecified "information and belief," Plaintiffs alleged that the Extell transaction had been "originated, negotiated, in negotiations, or otherwise present as an opportunity of the LLC and its members prior to January 18, 2007," the date of the buyout. R.58 ¶26; *see also* R.53 ¶9C, R.53 ¶9E, R.55 ¶14A, R.55-56 ¶15, R.58 ¶29, R.58 ¶30 (similar allegations made on "information and belief").

The Complaint contained 11 causes of action, including claims for breach of fiduciary duty (First Cause of Action, R.59-61 ¶¶31-39); conversion (Fourth Cause of Action, R.63-64 ¶¶53-56); unjust enrichment (Fifth Cause of Action, R.64 ¶¶57-60); and fraud/misrepresentation (Tenth Cause of Action, R.68-70 ¶¶79-86).

Fiduciary Duty (First Cause of Action): The Complaint alleged that, as a Member and Manager of the LLC, Tzolis "was and is a fiduciary for Pappas and Infantopoulos." R.59 ¶35 It further alleged that Tzolis's "failure to disclose to Pappas and Infantopoulos any agreement, or negotiations for such an agreement, relating to the purchase of the Lease" by Extell breached Tzolis's fiduciary "duty

of disclosure." R.59 ¶33; R.60 ¶¶36, 37. The First Cause of Action did not mention Pappas's and Infantopoulos's representation in the Certificate that Tzolis "ha[d] no fiduciary duty to the … Sellers" in connection with the challenged transaction (*see* R.126).

Conversion (Fourth Cause of Action): Plaintiffs alleged that Tzolis "appropriate[d] to himself, without justification, the ownership, rights, benefits and interest in and to the LLC that Plaintiffs had in their membership interests." R.63 ¶54.

Unjust Enrichment (Fifth Cause of Action): Plaintiffs alleged that "Tzolis's acts resulted in his unjustified, unlawful receipt of money or property with a value of $9,000,000 or more in excess of his 40% interest in the LLC," and that Tzolis was thereby "unjustly enriched." R.64 ¶¶58, 60. The Complaint did not explain how Tzolis could be "unjustly enriched" in an amount "in excess of his 40% interest" when Tzolis acquired 100% of the interests in the LLC pursuant to signed, written contracts in the buyout. *See* R.116-125.

Fraud and Misrepresentation (Tenth Cause of Action): The claim for "Fraud and Misrepresentation" claim alleged that Tzolis made "Implied Representations" that he was "aware of no reasonable prospects for selling the LLC's Lease or Property for an amount in excess of $2,500,000"; that "there were no negotiations with anyone for the sale of the Lease or the Property for an amount

in excess of $2,500,000"; that the LLC's law firm "had kept the Plaintiffs fully informed as to any negotiations or transactions concerning the Lease or Property"; and that "Pappas and Infantopolos [*sic*] had been fully represented by the LLC law firm and attorney prior to the time of the closing." R.69-70 ¶82.

None of those "Implied Representations" was contained in the any of the transaction documents from the buyout. The Complaint did not explain how a claim for fraud and misrepresentation could be maintained in the face of the Certificate's sworn affirmation that the sellers were "not relying on any representation by Steve Tzolis" (R.126). Nor did the Complaint explain how Plaintiffs could maintain an action based on an allegedly false "implied" representation that they had been "fully represented by the LLC law firm and attorney" (R.69-70 ¶82) when they certified in writing that they had "engaged [their] own legal counsel" in the transaction (R.126).

In the Complaint, Pappas demanded $6,000,000, Infantopolous demanded $3,000,000, and both sought prejudgment interest and attorneys' fees. R.71-74 ¶¶1, 4, 5, 10. On the fraud claim, Plaintiffs sought an additional "50% [of the demanded amount] representing the loss of opportunity for Pappas to have negotiated a better deal." R.74 ¶10.

E. The Motion Court's Decision

Tzolis moved to dismiss for failure to state a cause of action and based on documentary evidence under CPLR 3211(a)(1) and (a)(7). R.46. Supreme Court (Hon. Ira Gammerman, J.H.O.) granted the motion. R.39. Supreme Court held that the Operating Agreement, by providing that the members could "engage in business ventures and investments of any nature whatsoever, whether or not in competition with the LLC, without obligation of any kind to the LLC or to the other Members," had "eliminate(d) the fiduciary relationship that would, otherwise, be owed by the members to each other and to the LLC." R.41; *see* R.85 ¶11. That clause of the Operating Agreement, the motion court observed, "cannot be read to exclude business ventures involving the LLC." R.42. As Supreme Court further recognized, the Certificate signed in connection with the purchase confirmed the absence of fiduciary duties. R.41.

After holding that the claim for breach of fiduciary duty could not survive the express provisions of the Operating Agreement and the Certificate, Supreme Court observed that the factual basis for "every other cause of action in the complaint" was that "at the time that Tzolis purchased plaintiffs' interest in [the LLC], he failed to disclose to plaintiffs the possibility of a profitable assignment of the Lease to [Extell]." R.42. Because the Operating Agreement permitted such transactions and the buyout was voluntary and conducted at arm's length, the

fiduciary claim was deficient; dismissal of the Fourth, Fifth and Tenth causes of action logically followed. R.43-45.

F. The First Department's Decision

On Plaintiffs' appeal, the Appellate Division in an unsigned order affirmed the motion court's dismissal of all claims except for the First, Fourth, Fifth and Tenth causes of action. R.6-22. Over a vigorous dissent (R.22-30), a 3-2 majority of the Appellate Division reinstated those four remaining claims. R.6.

According to the majority, the Plaintiffs had "adequately alleged that Tzolis breached a fiduciary duty to keep them informed of any and all opportunities he was pursuing on behalf of [the LLC]." R.14. Although the Certificate expressly stated that Tzolis had "no fiduciary duty" in the challenged transaction (*see* R.126), the majority nonetheless imposed on him "an overriding duty to disclose his dealings with Extell to plaintiffs before they assigned their interests in [the LLC] to him." R.16. To find such a duty, the majority relied upon *Blue Chip Emerald v. Allied Partners*, 299 A.D.2d 278, 280 (1st Dep't 2002), which held that disclaimers in a buyout agreement were "voidable as the fruit of the fiduciary's breach of its obligation to make full disclosure."

As the majority acknowledged, *Blue Chip* had been "criticized" by this Court in *Centro Empresarial Cempresa S.A. v. America Movil, S.A.B. de C.V.*, 17 N.Y. 3d 269 (2011). R.18. The majority distinguished *Centro Empresarial*,

however, as involving an "exceedingly broad" release, and wrote that Tzolis had "made no showing that plaintiffs had any reason to suspect [him] of deceit or that they had the independent ability to discover facts that would have deterred them from selling their interests in [the LLC] to him." R.17-18.

The majority also saw "no evidence that plaintiffs and Tzolis were not still in a relationship of unquestioning trust at the time of the transaction at issue." R.18. The majority therefore reinstated Plaintiffs' claims for breach of fiduciary duty. Quoting *Blue Chip*, the majority adopted the view that, even though the parties had attempted to disclaim such duties in the Certificate, Tzolis still had fiduciary duties to the LLC and its members that persisted "until the moment the buy-out transaction closed." R.15.

Finding that an affidavit submitted by Pappas had "cured any defect" in the fraud claim, the majority of the First Department panel reinstated the Plaintiffs' cause of action for fraud. R.19-20. However, the Pappas Affidavit did not detail any fraudulent representations upon which Plaintiffs relied. Rather, it asserts without particularity that Pappas "discovered" that the lease assignment to Extell "was negotiated by Tzolis … before I and Gus Infantopoulos assigned our interests in Vrahos LLC to Tzolis" and that "Tzolis never disclosed this very lucrative opportunity to myself and Infantopolous." R.137 ¶24. Neither the Pappas Affidavit nor the majority of the Appellate Division panel attempted to explain

how the fraud claim could survive (i) the Operating Agreement's express elimination of all corporate opportunity duties when it allowed the Members to "engage in business ventures … of any nature whatsoever, whether or not in competition with the LLC, without obligation of any kind to the LLC or to the other Members" (R.85 ¶11); and (ii) the Certificate's statement that Tzolis "ha[d] no fiduciary duty" and that Pappas and Infantopolous had "engaged [their] own legal counsel," and were "not relying on any representation" by Tzolis. R.126.

The majority also reinstated Plaintiffs' claims for conversion and unjust enrichment, ruling that Plaintiffs were "entitled to litigate their claims that Tzolis's wrongful behavior constituted a conversion of a portion of their interests in [the LLC] and that equity dictates that Tzolis return the corresponding value to them." R.20.

The two dissenting Justices would have held that Plaintiffs' "contractual disclaimers … preclude the causes of action that the majority has reinstated." R.23. Plaintiffs' claim that Tzolis breached his fiduciary duty by allegedly failing to disclose negotiations with Extell could not survive the Certificate's express terms ("no fiduciary duty"), the dissenters explained. R.25. "Although Tzolis had a fiduciary relationship with Pappas and Infantopoulos before the closing, the certificate specifically discharged that fiduciary relationship and released Tzolis

from any liability arising from his fiduciary duty," the dissenting Justices wrote. R.26.

Citing this Court's decision in *Centro Empresarial*, the dissenting Justices observed that the parties dealt at arm's length in the buyout and should be bound to their agreements. Plaintiffs' acknowledgement in the Certificate that Tzolis was not their fiduciary and that they were not relying on any representations by him outside the closing documents "constituted fair notice that plaintiffs were engaging in an arm's length business transaction with Tzolis, that they should not place their 'unquestioning trust' in him, and that in exchange for their immediate and certain twentyfold return on their investment, they were forgoing the possibility of future greater profit." R.28.

With respect to the fraud claim, the dissenters found Plaintiffs' lack of due diligence to be "unreasonable as a matter of law" and fatal to the claim. R.30. Because the buyout was "unaffected by a fiduciary relationship" and the Plaintiffs received their bargained-for consideration, the dissenting Justices would have affirmed dismissal of the conversion and unjust enrichment claims as well. *Id*.

Upon Tzolis' motion for leave to appeal, by order dated January 19, 2012, the Appellate Division certified to this Court the following question: "Was the order of this Court, which modified in part and otherwise affirmed the order of the Supreme Court, properly made?" R.3. Tzolis respectfully submits that the

Appellate Division's September 15, 2011 Order should be reversed insofar as it modified Supreme Court's Order of March 4, 2010, and the complaint should be dismissed.

ARGUMENT

THE APPELLATE DIVISION ERRED IN HOLDING THAT, IN A BUYOUT OF TWO LLC MEMBERS' INTERESTS BY THE THIRD MEMBER, THE SELLERS COULD SUE FOR BREACH OF FIDUCIARY DUTY, CONVERSION, FRAUD AND UNJUST ENRICHMENT AFTER THE SELLERS CERTIFIED THAT THE BUYER HAD "NO FIDUCIARY DUTY" TO THEM AND THEY WERE "NOT RELYING ON ANY REPRESENTATION" BY THE BUYER

I. The Certificate and the Operating Agreement Effectively Disclaimed Fiduciary Duties.

The claim for breach of fiduciary duty fails in the face of one simple proposition: a plaintiff can't sue someone for breach of fiduciary duty after certifying in writing that the person "has no fiduciary duty" to him. *Compare* R.59 ¶35 *with* R.126.

The certificate that all parties signed as part of Tzolis's buyout of Plaintiffs' interests in the LLC expressly disclaimed any fiduciary duties that may have existed among them. "[I]n connection with their respective assignments to Steve Tzolis of their membership interests in Vrahos LLC," Plaintiffs each represented "that Steve Tzolis *has no fiduciary duty* to the undersigned Sellers [*i.e.*, Plaintiffs] in connection with such assignments." R.126. They further certified that they were "not relying on any representations by Steve Tzolis" and had retained their

own legal counsel. *Id.*

By signing the Certificate, Plaintiffs expressly disclaimed any fiduciary duties Tzolis may have owed them and proceeded to engage in an arm's-length buyout transaction. *See* R.26 (dissenting opinion).

The disclaimer of fiduciary duties was consistent with the Operating Agreement and Delaware law. Under Delaware's LLC statute, "[t]o the extent that, at law or in equity, a member or manager or other person has duties (*including fiduciary duties*) to a limited liability company or to another member," the member's or manager's duties "may be expanded or restricted *or eliminated* by provisions in the limited liability company agreement." 6 DEL. CODE. ANN. §18-1101(c) (emphasis added). Here, the members of the LLC did just that, by providing in the Operating Agreement that "[a]ny Member may engage in business ventures and investments *of any nature whatsoever … without obligation of any kind* to the LLC or to the other Members." R.85 ¶11 (emphasis added).

The disclaimer of fiduciary duties should be enforced. Just last year, this Court held that "[a] sophisticated principal is able to release its fiduciary from claims – at least where, as here, the fiduciary relationship is no longer one of unquestioning trust – so long as the principal understands that the fiduciary is acting in its own interest and the release is knowingly entered into." *Centro Empresarial Cempresa S.A. v. America Movil, S.A.B. de C.V.*, 17 N.Y.3d 269, 278

(2011); *accord Arfa v. Zamir*, 17 N.Y.3d 737, 738-39 (2011) (a "general release, which plaintiffs allege[d] was part of a negotiated agreement meant to ease an antagonistic relationship … prevent[ed] plaintiffs from … bringing an action for fraud based on misrepresentations predating it").

The result when fiduciary duties are *disclaimed* should be the same as when they are *released.* Federal courts applying New York law have long permitted parties to disclaim fiduciary duties freely. *See Summit Props. Int'l, LLC v. Ladies Prof'l Golf Assoc.*, 2010 WL 2382405 at *7 (S.D.N.Y. June 14, 2010) (Sand, D.J.) ("Given that the Agreement contains a clear and unambiguous disclaimer of a fiduciary relationship, we find there was no fiduciary duty between the parties."); *Seippel v. Jenkens & Gilchrist, P.C.*, 341 F.Supp.2d 363, 381-82 (S.D.N.Y. 2004) (Scheindlin, D.J.) ("The agreements explicitly stated that Deutsche Bank was not acting as a fiduciary to the Seippels. Because contractual disclaimers of fiduciary duty are effective in New York, no fiduciary duty can arise from the relationship between the Seippels and Deutsche Bank."); *Asian Vegetable Research & Dev. Center v. Inst. for Int'l Educ.*, 944 F. Supp. 1169, 1177-78 (S.D.N.Y. 1996) (Sweet, D.J.) (a disclaimer stating that "[n]othing in this Section 2.1 shall cause IIE to be a fiduciary" with respect to plans at issue was held to "effectively negate[] a fiduciary relationship between IIE and the Centers").

In *Centro Empresarial,* this Court wrote that, to the extent that cases like *Blue Chip Emerald v. Allied Partners,* 299 A.D.2d 278, 279-80 (1st Dep't 2002) suggest otherwise, "they misapprehend our case law." *Centro Empresarial,* 17 N.Y.3d at 178. In the decision below, however, the court majority relied squarely upon *Blue Chip.* R.41-43.

The First Department's majority opinion attempted to distinguish *Centro Empresarial* on three grounds: (i) there was no showing that Plaintiffs "had any reason to suspect Tzolis of deceit" or that Plaintiffs and Tzolis "were not still in a relationship of unquestioning trust" (R.17-18); (ii) there was no showing that Plaintiffs "had the independent ability to discover facts that would have deterred them from selling their interests" in the LLC (*id.*); and (iii) *Centro Empresarial* involved an "exceedingly broad release" rather than a disclaimer (*id.* at 17). None of those distinctions survives analysis.

A. As a matter of law, Plaintiffs did not share a trust relationship with Tzolis.

Plaintiffs cannot reasonably be held to have reposed "unquestioning trust" in Tzolis, for four reasons.

First, Plaintiffs affirmed in the Certificate that Tzolis did not owe them any fiduciary duties and they did not rely on any representation by him. *See* R.126. They are estopped from claiming otherwise after the buyout turned out to be more valuable to Tzolis than they thought.

Second, the Appellate Division improperly reversed the applicable burden of pleading. In reinstating the fiduciary claim, the First Department noted that *Tzolis* had "made no showing that plaintiffs had any reason to suspect [him] of deceit or that they had the independent ability to discover facts that would have deterred them from selling their interests in [the LLC] to him." R.17-18. The majority also saw "no evidence that plaintiffs and Tzolis were not still in a relationship of unquestioning trust at the time of the transaction at issue." R.18.

Placing on Tzolis the burden of pleading a reason for suspicion, or an absence of trust, was improper. Rather, the Plaintiffs were required to plead their cause of action in detail. *See* CPLR 3016 (where cause of action is based on "breach of trust," the "circumstances constituting the wrong shall be stated in detail"); *accord Palmetto Partners, L.P. v. AJW Qualified Partners, LLC,* 83 A.D.3d 804, 808 (2d Dep't 2011) (citing numerous cases).

When the proper pleading standard is applied, the Complaint must be dismissed. Rather than establishing "unquestioning trust," Plaintiffs' pleading shows the opposite. Plaintiffs affirmatively allege multiple disagreements between themselves and Tzolis over fundamental issues relating to conduct of the business. *See* R.52-53 ¶¶9A-9B, 9D-9E, 132 ¶15.C(iii), 133-134 ¶¶16-20.

Third, the Certificate reflected the terms of the Operating Agreement. It would have been unreasonable as a matter of law for one member of this LLC to

repose "unquestioning trust" in another member when, as an express condition of the relationship, each member was entitled to "engage in business ventures and investments of any nature whatsoever, whether or not in competition with the LLC, without obligation of any kind to the LLC or to the other Members." R.85 ¶11.

The Operating Agreement's provision effectively eliminating the duty to disclose corporate opportunities is entitled to deference under Delaware law. Delaware's LLC Act provides that "[i]t is the policy of this chapter to give the *maximum effect to the principle of freedom of contract* and to the enforceability of limited liability company agreements." 6 DEL. CODE. ANN. §18-1101(b) (emphasis added). The Act further provides that "duties may be expanded or restricted *or eliminated* by provisions in the limited liability company agreement." 6 DEL. CODE. ANN. §18-1101(c) (emphasis added). Members of Delaware LLCs especially have the ability to "define the contours of their relationships with each other to the maximum extent possible." *CML V, LLC v. Bax*, 28 A.3d 1037, 1043 (Del. 2011).

Holding that no fiduciary duty existed would thus give effect to the parties' expectations. The LLC was structured so that the members were free to compete against one another and the LLC; therefore, each member was legally permitted to act without regard to the others' interests. *See* R.85 ¶11; *see generally see also Everett v. Phillips,* 288 N.Y. 227, 236-37 (1942) (provision of certificate of

incorporation authorizing directors to act "even in matters where they have dual interests" had effect of "exonerating the directors, at least in part" from adverse inferences that otherwise would result from conflict of interest).

Fourth, in economic reality, the relationship was one of debtor and creditor, not a fiduciary one. Following the Sublease, 108 Realty (Tzolis's company) was to pay about $20,000 net each month to the LLC. R. 93, 107. The Sublease was for the Lease's entire term of more than 48 years (less one day). *Compare* R.93 §1.9 *with* R.142. Thus, as a practical matter, the receivable from 108 Realty was the LLC's sole asset. The LLC had no upside if the value of the Lease appreciated. It had no downside, unless 108 Realty failed to pay and Tzolis, its guarantor, became judgment-proof. Tzolis was not the steward of any assets of the LLC; rather, the payment obligation of 108 Realty *was* the LLC's asset. Under New York law, the debtor-creditor relationship shared by the parties pre-buyout cannot be bootstrapped into a fiduciary one. *See Dobroshi v. Bank of America, N.A.*, 65 A.D.3d 882, 884 (1st Dep't 2009) ("This Court has repeatedly held that an arm's length borrower-lender relationship is not of a confidential or fiduciary nature[.]") (collecting cases).

In the buyout, the Plaintiffs exchanged their portion of a fixed monthly receivable of about $20,000[2] for a large, immediate lump-sum payout of $1.5 million. As part of that deal, Tzolis purchased their interests in the LLC. The Plaintiffs were not unfairly deprived of anything. Instead, they made a voluntary exchange for substantial consideration. The Certificate executed in that transaction confirmed that – both in the buyout and in their previous relations – Tzolis was not Plaintiffs' fiduciary and vice versa. R.126.

This Court has cautioned that fiduciary duties should not be superimposed on ordinary business relationships. "If the parties find themselves or place themselves in the milieu of the 'workaday' mundane marketplace, and if they do not create their own relationship of higher trust, courts should not ordinarily transport them to the higher realm of relationship and fashion the stricter duty for them." *Northeast Gen. Corp. v. Wellington Adver., Inc.,* 82 N.Y.2d 158, 162 (1993) (no fiduciary duty may be imposed where, as in the buyout transaction here, the operative agreement "contains no cognizable fiduciary terms or relationship"). The law of Delaware, where the LLC was chartered, is in accord. *See Wal-Mart Stores, Inc. v. AIG Life Ins. Co.*, 901 A.2d 106, 114 (Del. 2006) (agreeing with lower court that "it is vitally important that the exacting standards of fiduciary duties not be extended to quotidian commercial relationships").

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[2] Because the Plaintiffs together owned 60% of the LLC, their share of the monthly receivable would have been about $12,000.

B. Plaintiffs were not relying on Tzolis's representations.

As a matter of law, Plaintiffs were not relying on Tzolis's representations. In the Certificate, they represented expressly that they had engaged their own legal counsel and were "not relying on any representation by Steve Tzolis." *See* R.126.

Even before the Certificate was executed, the parties did not coexist harmoniously. Both the Complaint and Pappas's affidavit detail numerous disagreements and disputes among them. *See* R.52-53 ¶¶9A-9B, 9D-9E, 132 ¶15.C(iii), 133-134 ¶¶16-20. The parties resolved their disputes and terminated their relationship through the commonly-used device of a buyout. This court spoke directly to the point in *Centro Empresarial*: "[w]here a principal and fiduciary are sophisticated parties engaged in negotiations to terminate their relationship …, the principal cannot blindly trust the fiduciary's assertions." 17 N.Y.3d at 279.

C. The Certificate's disclaimer has the same effect on fiduciary duties as a release.

As the dissent in the Appellate Division recognized, "[i]t is immaterial that instead of signing a general release plaintiffs executed a certificate disclaiming Tzolis's fiduciary duty and his earlier representations." R.29. The Certificate stated that Tzolis "has no fiduciary duty to the undersigned Sellers in connection with [the] assignments" of their interests. R.126. By executing that document, the parties reaffirmed that Tzolis was not a fiduciary. In the dissenting Justices' words, the Certificate was "tantamount to a release from all claims against Tzolis

in connection with the assignment that were premised on his fiduciary duty to plaintiffs." R.29.

This court's decision in *Centro Empresarial* should not be applied narrowly to releases alone. Rather, it stands for the more expansive proposition that parties to a buyout may structure their transaction to avoid the imposition of fiduciary duties. Undoubtedly, that is what the parties here intended to do when they executed the Certificate, which provided that *neither* side owed fiduciary duties to the other in connection with the buyout.

To establish a breach of fiduciary duty, the Plaintiffs must prove the existence of the duty. *JFK Family Ltd. Partnership v. Millbrae Natural Gas Development*, 89 A.D.3d 684, 685 (2d Dep't 2011); *accord Heller v. Kiernan,* 2002 WL 385545, at *3 (Del. Ch. Feb. 27, 2002). Because the buyout was intended to, and did, remove any fiduciary duties that may have applied to the parties' relationship, a fiduciary claim cannot be maintained.

II. The Complaint Fails to State a Cause of Action for Conversion

The Complaint and the governing contracts fail to support – and affirmatively defeat – a cause of action for conversion. Conversion is the "unauthorized assumption and exercise of the right of ownership over goods belonging to another to the exclusion of the owner's rights." *Vigilant Ins. Co. of America v. Housing Authority of City of El Paso*, 87 N.Y.2d 36, 44 (1995) (internal

quotations omitted). To sustain a claim for conversion, a plaintiff must demonstrate (i) his possessory right or interest in property; and (ii) defendant's dominion over the property or interference with it, in derogation of plaintiff's rights. *Colavito v. New York Organ Donor Network, Inc.*, 8 N.Y.3d 43, 50 (2006).

Here, the claim for conversion is premised on the allegation that Tzolis "appropriate[d] to himself, without justification, the ownership, rights, benefits and interest in and to the LLC that Plaintiffs had in their membership interests." R.63 ¶54. That allegation is defeated by documentary evidence: for substantial consideration, both Pappas and Infantopoulos assigned their interests in the LLC to Tzolis. R.116-120; R.121-125. A voluntary commercial transaction cannot be an act of conversion. *See Five Star Bank v. CNH Capital America, LLC*, 55 A.D.3d 1279, 1281 (4th Dep't 2008) (rejecting a conversion claim when "the exercise of dominion and control was not unauthorized"); *see also Colavito*, 8 N.Y.3d at 49-50 (stating that conversion requires an assumption of control over property "without authority").

The First Department revived the conversion claim "based on our finding that, because of Tzolis's [alleged] surreptitious behavior, plaintiffs did not sell their interests in [the LLC] willingly or at arm's length." R.20. That analysis is backwards. The existence of a duty to disclose depends on whether a transaction is conducted at arm's length, not the other way around. *See Havell Capital Enhanced*

Mun. Income Fund, L.P. v. Citibank, N.A., 84 A.D.3d 588, 589 (1st Dep't 2011) ("Absent a confidential or fiduciary relationship, defendant was not under a duty to disclose…"); *Sehera Food Services Inc. v. Empire State Bldg. Co. L.L.C.*, 74 A.D.3d 542, 543 (1st Dep't 2010) ("there is no duty to disclose in a nonfiduciary, arm's length transaction between a landlord and tenant"); *Kahn v. Tremont Corp.*, 694 A.2d 422, 432 (Del. Super. Ct. 1997) (finding a party had "no duty to disclose information which might be adverse to its interests because the normal standards of arms-length bargaining do not mandate a disclosure of weaknesses").

The parties in this case made clear that Tzolis's buyout of the other interests was conducted at arm's length. They executed a Certificate stating that the purchaser "ha[d] no fiduciary duty" and that the sellers had "performed their own due diligence," "engaged [their] own legal counsel," and were "not relying on any representation" by the purchaser. R.126. Even before the buyout, the LLC's Operating Agreement allowed each member to "engage in business ventures and investments *of any nature whatsoever*, whether or not in competition with the LLC, *without obligation of any kind* to the LLC or to the other Members." R.85 ¶11 (emphasis added).

Because the parties dealt at arm's length, even if there had been negotiations with a subsequent buyer, the purchaser had no duty to disclose them.

That the buyout was "willing" is established conclusively by the governing documents. It was made "in exchange for the payment … of … good and valuable consideration, the receipt whereof *and sufficiency of which* are hereby acknowledged by the parties." R.116, 121 (emphasis added). All parties executed the buyout documents "intending to be legally bound." R.116, 121; *accord* R.118, 123 ("[t]his assignment shall be binding upon … Assignor"). Each party consented to the transfer of the interests. R.117 ¶4; R. 122 ¶4.

Were the Appellate Division's decision to be sustained, any seller suffering from post-sale dissatisfaction could support a claim for "conversion" by alleging that the other side engaged in "surreptitious behavior." *See* R.20. That is not the purpose of a conversion claim, and would effectively destroy the finality of buyout agreements under New York law.

III. The Cause of Action for Unjust Enrichment is Defeated by Documentary Evidence

Plaintiffs' unjust enrichment claim similarly fails in the face of the parties' written contracts. "[T]he essential inquiry in any action for unjust enrichment … is whether it is against equity and good conscience to permit the defendant to retain what is sought to be recovered." *Sperry v. Crompton Corp.,* 8 N.Y.3d 204, 215 (2007) (citation omitted).

Yet, the cause of action for unjust enrichment does not allow parties to renegotiate and restructure their deals because they are not satisfied with the

results. *See Dragon Inv. Co. II LLC v. Shanahan*, 49 A.D.3d 403, 405 (1st Dep't 2008) ("[a] claim for unjust enrichment does not lie to relieve a party 'of the consequences of [the party's] own failure to … exercise caution with respect to a business transaction'"), quoting *Charles Hyman, Inc. v. Olsen Indus.*, 227 A.D.2d 270, 277 (1st Dep't 1996).

Rather, unjust enrichment is a quasi-contractual claim, imposed by equity to prevent injustice "in the *absence* of an actual agreement between the parties concerned." *IDT Corp. v. Morgan Stanley Dean Witter & Co.*, 12 N.Y.3d 132, 142 (2009) (emphasis added). "Where the parties executed a valid and enforceable written contract governing a particular subject matter, recovery on a theory of unjust enrichment for events arising out of that subject matter is ordinarily precluded." *Id.*, citing *Clark-Fitzpatrick, Inc. v. Long Is. R.R. Co.*, 70 N.Y.2d 382, 388 (1987) (the existence of a valid and enforceable written contract governing a particular subject matter "ordinarily precludes recovery in quasi contract"); *Bradkin v. Leverton,* 26 N.Y.2d 192, 196 (1970) (quasi-contractual obligations are "imposed by law where there has been no agreement or expression of assent, by word or act, on the part of either party involved").

When there exists a relevant contract between the parties, there can be no recovery under an unjust enrichment theory for events arising out of the agreement. *See Cox v. NAP Const. Co., Inc.*, 10 N.Y.3d 592, 607 (2008) ("[A] party may not

recover in … unjust enrichment where the parties have entered into a contract that governs the subject matter."); *Goldman v. Metropolitan Life Ins. Co.*, 5 N.Y.3d 561, 572 (2005) ("[T]here was no unjust enrichment because the matter is controlled by contract.").

Here, Tzolis and the Plaintiffs were parties to the Operating Agreement (R.77-89), as well as the Certificate (R.126) and the Agreements of Assignment and Assumption by which Tzolis acquired the Plaintiffs' interests in the LLC (R.116-125). The parties' relationships were also governed by the Lease (R.139-217) and the Sublease (R.90-115). The existence of those written contracts is expressly pleaded in the Complaint.[3]

The courts should not be invited, based on a cursory pleading (R.64), to upset that interwoven series of sophisticated, written business agreements by declaring them "unjust" on the ground that Tzolis profited more than Pappas or Infantopoulos. This is not a case where unjust enrichment may be applied.

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[3] *See* R.51 ¶7, R.52 ¶8A, R.59 ¶32, R.60-61 ¶39A, R.69 ¶80 (Operating Agreement); R.53-54 ¶10, R.54-55 ¶¶12, 13, R.56 ¶19, R.57 ¶23, R.58 ¶30, R.65 ¶¶62-63, R.68 ¶77 (Agreements of Assignment and Assumption); R.54 ¶11, R.55-56 ¶15, R.65 ¶¶62-63, R.68 ¶77 (Certificate); R.52 ¶9, R.53 ¶9E, R.56 ¶15A, R.58 ¶¶25, 29, R.59-60 ¶¶35-39, R.61 ¶43, R.62 ¶¶45-46, R.62 ¶49, R.63 ¶¶51-52, R.63 ¶54, R.64 ¶56, R.66 ¶¶67-68, R.67 ¶70, R.69-70 ¶¶81-82, R.71 ¶¶89-90, R.72 ¶6, R.73 ¶7 (Lease); R.52-53 ¶9A-9B, R.65 ¶¶62-63 (Sublease); *see also* R.57 ¶20, R.65 ¶¶62-63, R.68 ¶77 (Estoppel Agreement).

IV. The Documentary Evidence Bars the Cause of Action for Fraud and Misrepresentation

Like Plaintiffs' fiduciary claim, the claim for "fraud and misrepresentation" faces a basic stumbling block: a plaintiff cannot sue for "Implied Misrepresentations" when he has certified in writing that he was "not relying on any representation" by the defendant. *Compare* R.126 (Certificate) *with* R.69-70 ¶82 (Complaint). The plain language of the phrase "[a]ny representation" encompasses implied, as well as express, representations.

As the dissent noted, "[e]ven if plaintiffs had the right to place their trust in Tzolis before they signed the certificate, that right necessarily ended when they executed it." R.29. Numerous New York cases have held that a contractual disclaimer of reliance precludes causes of action for fraud based on the matters disclaimed. *See, e.g., Danann Realty Corp. v. Harris,* 5 N.Y.2d 317, 320-21 (1959) (specific disclaimer about not relying on representations destroyed allegations of reliance on oral representations); *Pitt Street, LLC v. 85-87 Pitt Street Realty Corp.,* 83 A.D.3d 446, 446 (1st Dep't 2011) (provision disclaiming reliance on representations extinguished misrepresentation claims); *Laxer v. Edelman,* 75 A.D.3d 584, 586 (2d Dep't 2010) ("a cause of action alleging fraudulent inducement may not be maintained if specific disclaimer provisions in the contract of sale disavow reliance upon oral representations"); *Daly v. Kochanowicz,* 67 A.D.3d 78, 94-95 (2d Dep't 2009) (specific disclaimer barred plaintiff's

misrepresentation claims); *Valassis Communications, Inc. v. Weimer,* 304 A.D.2d 448, 448 (1st Dep't 2003) ("[i]n light, however, of provisions of the parties' Purchase Agreement specifically prohibiting plaintiffs' reliance on extra-contractual representations such as those upon which plaintiffs' fraud claim is premised, it is plain that plaintiffs possess no viable claim for fraud.").

To the extent that Plaintiffs rely upon a "duty to disclose," none exists because the parties dealt at arm's length. *See Dembeck v. 220 Cent. Park South, LLC,* 33 A.D.3d 491, 492 (1st Dep't 2006) ("[a] fiduciary relationship does not exist between parties engaged in an arm's length business transaction"; consequently, "[d]efendant was under no obligation to volunteer any information concerning contemplated future repairs to the elevator or any other systems in the building").

A duty to disclose would likewise be inconsistent with the Operating Agreement's provision that "[a]ny Member may engage in business ventures and investments of any nature whatsoever, whether or not in competition with the LLC, *without obligation of any kind* to the LLC or to the other Members." R.85 ¶11. Disclosure duties are among the many "obligation[s] of any kind" that this provision eliminated.

Thus, the disclosure duty arising under the "special facts" doctrine is inapplicable to this LLC and these parties. Even if "special facts" doctrine were to

apply, however, a duty to disclose would arise only when "one party's superior knowledge of essential facts renders a transaction without disclosure inherently unfair." *See, e.g., Jana L. v. West 129th St. Realty Corp.*, 22 A.D.3d 274, 277 (1st Dep't 2005). To establish a duty under the "special facts" doctrine, "as a threshold matter," a party must show that the information was "peculiarly within [the] knowledge" of one party, and the other party could not have discovered it through the "exercise of ordinary intelligence." *Id.* at 278. The use of "ordinary intelligence" imposes, "at the very least," a duty to inquire. *Id.* That duty may be satisfied by "a simple inquiry … at closing." *Id.*

Here, neither element of the "special facts" doctrine was met.

First, the value of Pappas's and Infantopoulos's interests in the LLC – the subject matter of the dispute – was not peculiarly within Tzolis's knowledge. The LLC's sole asset was the right to receive about $20,000 per month net under the Sublease. *See* R.6-7. That right, and Plaintiffs' share of it, could be valued easily.

Even if one accepts Plaintiffs' false assumption that (contrary to the Sublease agreement) the LLC retained some upside from development of the leasehold, the Plaintiffs could have obtained an appraisal of the property and valued the Lease. They could have conducted a market check on what developers were paying for long-term leaseholds on parcels like the one at issue. They could have examined the value of real estate in the area, the neighborhood's potential for

redevelopment, and similar elements. There is no allegation that they did any of those things.

Second, Plaintiffs failed in their duty to inquire. They do not allege that they made "a simple inquiry … at closing," *see Jana L.,* 22 A.D.3d at 278, as to whether Tzolis had discussions with any prospective purchaser. When ordinary means are available to obtain information, plaintiffs may not allege fraudulent misrepresentation or concealment if they have not first attempted to use those means. *See Stuart Silver Associates, Inc. v. Baco Development Corp.*, 245 A.D.2d 96, 98-99 (1st Dep't 1997).

Indeed, the record contains no evidence or allegation that the Plaintiffs made any inquiries or attempts to obtain information whatsoever. As the motion court pointedly observed, "the complaint does not allege that either Pappas, or Infantopolous posed any questions to Tzolis as to why he was suddenly offering them, respectively, $1 million and $500,000 in return for their respective investments, one year earlier, of $50,000 and $25,000." R.45.

Having failed in their duty to inquire, Plaintiffs do not satisfy the second threshold for applying the "special facts" doctrine. Consequently, no duty of disclosure can be imposed on Tzolis in any event.

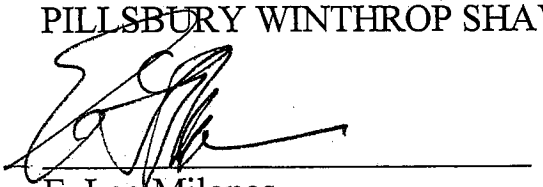
CONCLUSION

The decision of the Appellate Division, First Department should be reversed insofar as it reinstated Plaintiffs-Respondents' First, Fourth, Fifth and Tenth Causes of Action, and the Complaint should be dismissed.

Dated: March 19, 2012

Respectfully submitted,

PILLSBURY WINTHROP SHAW PITTMAN LLP



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NEW YORK STATE
COURT OF APPEALS

STEVE PAPPAS and CONSTANTINE INFANTOPOULOS, Individually, and Derivatively on Behalf of VRAHOS LLC, Plaintiffs-Respondents, -against- STEVE TZOLIS, Defendant-Appellant, VRAHOS LLC, Defendant.	New York County Clerk's Index No. 601115/2009 AFFIDAVIT OF SERVICE

STATE OF NEW YORK)
: ss.:
COUNTY OF NEW YORK)

Hayley T. Allis, being duly sworn, deposes and says: I am over 18 years of age, am employed by Pillsbury Winthrop Shaw Pittman LLP and am not a party to this action.

On March 19, 2012, I served the following documents:

1. Brief for Defendant-Appellant, dated March 19, 2012, and

2. Record on Appeal, upon respondent's counsel herein by delivering to and leaving three true copies thereof at the office of counsel for the parties as follows:

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Hayley T. Allis

Sworn to before me this
19th day of March, 2012

Notary Public

LIZA JOGLAR
Notary Public, State of New York
No. 01JO6188769
Qualified in New York County
Commission Expires June 16, 2012