To Be Argued By:
E. LEO MILONAS

New York County Clerk's Index No. 601115/09

Court of Appeals

STATE OF NEW YORK

STEVE PAPPAS and CONSTANTINE IFANTOPOULOS,

Plaintiffs-Respondents,

- *against* –

STEVE TZOLIS,

Defendant-Appellant,

- *and* –

VRAHOS LLC,

Defendant.

REPLY BRIEF FOR DEFENDANT-APPELLANT

E. LEO MILONAS
FREDERICK A. BRODIE
PETER OSTROVSKI
PILLSBURY WINTHROP SHAW PITTMAN LLP
1540 Broadway
New York, NY 10036-4039
(212) 858-1000

ERIC S. WEINSTEIN
YONG HAK KIM
ELLENOFF GROSSMAN & SCHOLE LLP
150 East 42nd Street
New York, NY 10017
(212) 370-1300

Attorneys for Defendant-Appellant Steve Tzolis

TABLE OF CONTENTS

Page

PRELIMINARY STATEMENT 1

ARGUMENT

PLAINTIFFS HAVE FAILED TO SHOW ANY LEGALLY COGNIZABLE GROUND FOR AVOIDING THE TERMS OF THE TRANSACTION DOCUMENTS IN THEIR SALE OF LLC INTERESTS TO TZOLIS 2

I. The Certificate and the Operating Agreement Effectively Disclaimed Fiduciary Duties and Thus Barred the First Cause of Action. 2

A. Tzolis did not owe fiduciary duties to the Plaintiffs 2

B. The Complaint and the documentary evidence establish that the LLC was paid in full for the Lease. 7

C. The Certificate was not void. 10

II. Plaintiffs Have Failed to Show a Legal Basis for The Fourth Cause of Action for Conversion. 11

III. Plaintiffs' Fifth Cause of Action for Unjust Enrichment Fails Because the Parties' Relations Were Governed by Written Contracts. 12

IV. The Documentary Evidence Bars the Tenth Cause of Action for Fraud and Misrepresentation. 13

CONCLUSION 15

TABLE OF AUTHORITIES

CASES

Page

Auriga Capital Corp. v. Gatz Properties, LLC, 2012 WL. 361677 (Del. Ch. Jan. 27, 2012) 5, 6

Centro Empresarial Cempresa S.A. v. America Movil, S.A.B. de C.V., 17 N.Y.3d 269 (2011) 6

Citibank, N.A. v. Plapinger, 66 N.Y.2d 90 (1985) 13

In re Digex Inc. Shareholders Litigation, 789 A.2d 1176 (Del. Ch. 2000) 8

Galbreath v. Gulf Oil Corp., 294 F. Supp. 817 (N.D. Ga. 1968) 4

Glenn v. Hoteltron Systems, Inc., 74 N.Y.2d 386 (1989) 8

Kahn v. Icahn, 1998 WL. 832629 (Del. Ch. Nov. 12, 1998) 4

Related Westpac LLC v. JER Snowmass LLC, 2010 WL. 2929708 (Del Ch. July 23, 2010), *quoted in Auriga,* 2012 WL 361677at n.51 5

STATUTES AND CODES

Delaware Code Ann.
Title 6, Section 18-1101(a) 3
Title 6, Section 18-1101(b) 3
Title 6, Section 18-1101(c) 2, 3

PRELIMINARY STATEMENT

Steve Tzolis, respectfully submits this Reply Brief to address the arguments in the May 3, 2012 Brief of Plaintiffs-Respondents Steve Pappas and Constantine Ifantopoulos ("P.Br."), and in further support of his appeal.[1]

This is a case of sellers' remorse. Plaintiffs seek to challenge the closed and consummated sale of their interests in an LLC to the LLC's other member. Their remorse is perhaps understandable, since – months after Plaintiffs had assigned their interests in the LLC to Tzolis – the LLC sold the leasehold interest it owned to a developer at a profit. However, Plaintiffs' legal theories for overcoming the plain terms of their transaction documents and the LLC's Operating Agreement are meritless.

In particular, as part of the buyout, the fiduciary duties of the LLC members to each other were unambiguously disclaimed. Absent from the sellers' opposition brief is any reasoned analysis or refutation of the authority supporting enforcement of that disclaimer and the other governing provisions of the Operating Agreement and the transaction documents. The key points of Plaintiffs' opposition brief are refuted below.

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[1] The abbreviations and citation forms adopted in the March 19, 2012 Brief for Defendant-Appellant ("D.Br.") are continued herein.

ARGUMENT

PLAINTIFFS HAVE FAILED TO SHOW ANY LEGALLY COGNIZABLE GROUND FOR AVOIDING THE TERMS OF THE TRANSACTION DOCUMENTS IN THEIR SALE OF LLC INTERESTS TO TZOLIS

I. The Certificate and the Operating Agreement Unambiguously Disclaimed Fiduciary Duties, Thus Barring the First Cause of Action.

Tzolis's Opening Brief made a simple and straightforward argument for reversing the First Department's holding that Plaintiffs had stated a fiduciary claim: a plaintiff cannot sue for breach of fiduciary duty after having certified in writing that the defendant "has no fiduciary duty" in connection with the underlying transaction. D.Br. 17; *see* R.126. Plaintiffs' fusillade of novel legal attacks fails to repair that basic flaw in their claim.

A. Tzolis did not owe fiduciary duties to the Plaintiffs.

Under both the Certificate and the Operating Agreement, Tzolis did not owe a fiduciary duty to the Plaintiffs that would have required him to disclose any dealings he may have had with Extell, a potential purchaser of the Lease.

First, Plaintiffs argue that Delaware's LLC law "requires an explicit provision in the Operating Agreement to eliminate traditional fiduciary duties" otherwise owed by the members. P.Br. 18.

The Delaware statute – which Plaintiffs do not quote – provides that an LLC member's or manager's fiduciary duties "may be expanded or restricted or

eliminated by provisions in the limited liability company agreement." 6 DEL. CODE. ANN. §18-1101(c). The same statute further provides that "[t]he rule that statutes in derogation of the common law are to be strictly construed shall have no application" and "[i]t is the policy of this chapter to give the maximum effect to the principle of freedom of contract." 6 DEL. CODE. ANN. §§18-1101(a), (b).

The statute does *not* say that a provision in the operating agreement is the *only* way to expand, restrict or eliminate fiduciary duties. Nothing in the LLC statute suggests that a certificate, confirming that a buyer "has no fiduciary duty" to the sellers in connection with a transaction (*e.g.*, R.126), would be ineffective.

Second, the Operating Agreement in this case *did* "restrict[]" or "eliminate[]" the parties' "traditional fiduciary duties," as it was permitted to do under Delaware law. *See* 6 DEL. CODE. ANN. §§18-1101(c); D.Br. 22. Paragraph 11 of the Operating Agreement stated 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 (emphasis added); *see* D.Br. 18. That extremely broad provision covered *any* business venture *of any nature* and *all* obligations to the LLC or the other Members.[2]

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[2] Plaintiffs incorrectly state that the Operating Agreement's sole purpose was "to develop a single property" (P.Br. 3). In fact, the LLC's business included "any other lawful act or activities" permitted by the Delaware LLC statute. R.77 ¶4(d).

Delaware law does not require that a restrictive provision in an operating agreement (*e.g.*, R.85 ¶11) use the words "fiduciary duty" to be effective under §18-1101(c). The Delaware Chancery Court examined a provision similar to the one here in *Kahn v. Icahn*, 1998 WL 832629 (Del. Ch. Nov. 12, 1998), in which a real estate limited partnership agreement allowed the partners to "compete, directly or indirectly with the business of the Partnership." *Id.* at *1. The court upheld that clause as a valid disclaimer of fiduciary duties under Delaware law. *Id.* at *2-*3.

Contrary to Plaintiffs' argument (P.Br. 4), the phrase "whether or not in competition with the LLC" does not affect the meaning of "business ventures and investments of any nature whatsoever," the preceding phrase in the Operating Agreement. R.85 ¶11. When the word "whether" is preceded by words of general description, courts have held that the language following "whether" does not restrict the generality of the preceding description, but rather expands it through the use of an example. *See Galbreath v. Gulf Oil Corp.*, 294 F. Supp. 817, 824 (N.D. Ga. 1968) (discussing cases).

Plaintiffs concede that paragraph 11, "at best,"as a whole, is "a limitation of fiduciary duties among the Managers that was created with the Operating Agreement." P.Br. 19-20. That interpretation supports Tzolis's position. It is unnecessary to determine the full extent of paragraph 11's reach: at a minimum, paragraph 11 *limited* Tzolis's fiduciary duties so that they did not apply in the

context at issue: an alleged business transaction ("venture") with a potential purchaser of the LLC's interest in the Lease.

Third, Plaintiffs cite *Auriga Capital Corp. v. Gatz Props., LLC,* 2012 WL 361677 (Del. Ch. Jan. 27, 2012) for the proposition that "default fiduciary duties" cannot be eliminated. P.Br. 18. In fact, *Auriga* says the opposite. Chancellor Strine wrote that Delaware's LLC Act "lets contracting parties modify *or even eliminate* any equitable fiduciary duties." 2012 WL 361677 at *7 (emphasis added). As he recognized, under the governing Delaware Act, "[w]here the parties have clearly supplanted default [fiduciary] principles in full, [courts] give effect to the parties' contract choice." *Id.* at *9 (footnote omitted).

In other words, when the parties' contracts "cover a particular subject in an express manner, their contractual choice governs and cannot be supplanted by the application of inconsistent fiduciary duty principles that might otherwise apply as a default." *Related Westpac LLC v. JER Snowmass LLC,* 2010 WL 2929708, at *8 (Del Ch. July 23, 2010), *quoted in Auriga,* 2012 WL 361677at n.51.

In *Auriga,* the LLC agreement "ma[de] clear that the manager could only enter into a self-dealing transaction, such as its purchase of the LLC, if it proves that the terms were fair," thus "essentially incorporat[ing] a core element of the traditional fiduciary duty of loyalty." *Auriga,* 2012 WL 361677 at *2. Here, in contrast, the parties' Operating Agreement contained no such clause. Rather,

unlike the LLC agreement in *Auriga,* the Operating Agreement here expressly 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. Nor did the parties in *Auriga* execute a Certificate like the one here, which established expressly that each party "has no fiduciary duty" to the others "in connection with [the] assignments" of Plaintiffs' LLC interests. R.126.

Finally, Plaintiffs address only one of the three cases cited by Tzolis to show that fiduciary duties may be waived or disclaimed. *Compare* D.Br. 19 *with* P.Br. 19-20. Their attempt to distinguish that case as involving a "clear and unambiguous disclaimer" (P.Br. 19) fails: the Certificate's statement that Tzolis "has no fiduciary duty to the ... sellers" (R.126) is indeed a clear and unambiguous disclaimer.

Viewed separately or together, the Certificate and paragraph 11 of the Operating Agreement establish that the parties were dealing at arm's length. *See* D.Br. Point I.A; *see also* R.52-53 ¶¶9A, 9B, 9D, 9E; R.132-134 ¶¶15.C, 16-17, 19-20 (detailing disputes between Plaintiffs and Tzolis that led to buyout). Enforcing the Certificate thus would be fully consistent with this Court's ruling in *Centro Empresarial Cempresa S.A. v. America Movil, S.A.B. de C.V.,* 17 N.Y.3d 269, 278 (2011). *See* D.Br. 18-19, 25-26, discussing that case.

B. The Complaint and the documentary evidence establish that the LLC was paid in full for the Lease.

Plaintiffs' inflammatory accusation that Tzolis "stole" the LLC's asset (P.Br. 6-7, 17) is refuted both by documentary evidence and by Plaintiffs' Verified Complaint. Documentary evidence from the New York City Department of Finance, reproduced in the Record, shows the Lease was assigned *by the LLC* in August 2007, in exchange for *payment of $17,500,000.* R.225. Thus, the LLC received the consideration for its interest in the Lease. The Complaint even pleads this transaction expressly: "On or about August 28, 2007, *the LLC*, through Tzolis, assigned the Lease to a third party, Charlton Soho LLC, *in exchange for $17,500,000.*" R.58 ¶25.

Plaintiffs no longer held any interest in the LLC when it sold the Lease for $17,500,000. In the buyout, which had occurred six months previously, Pappas and Ifantopoulos each executed an Assignment under which they "hereby assign[ed] and transfer[red], to the Assignee [*i.e.*, Tzolis] Assignor's Interest in the LLC." R.117 ¶2, 120; R.122 ¶2, 125. As a result, Tzolis became "the holder of the Interest in the LLC, in each case as of the Effective Date." R.117 ¶3; R.122 ¶3. The effective date was February 20, 2007. R.57 ¶¶21-23. From that day forward, Tzolis owned 100% of all interests in the LLC, both membership and managerial. He was not required to consult with, make disclosures to, or obtain consents from, the former members and managers. *Compare* P.Br. 1, 5-6, 24. That is the typical

effect of a buyout.

The fact that the LLC sold the Lease and received all of the proceeds also defeats Plaintiffs' attempt to recast their claim as "the taking of a corporate opportunity" (P.Br. 6). The LLC *realized* on the opportunity to sell the Lease to Extell and was paid for its asset. Moreover, corporate opportunity claims may be brought only in a derivative, not a direct, capacity. *Glenn v. Hoteltron Sys., Inc.*, 74 N.Y.2d 386, 392-93 (1989); *accord In re Digex Inc. S'holders Litig.*, 789 A.2d 1176, 1189-90 (Del. Ch. 2000). Plaintiffs originally asserted such a claim (R.61-62), but Justice Gammerman correctly dismissed it as barred by ¶11 of the Operating Agreement (R.43). The First Department affirmed on the ground that the LLC, not Tzolis, assigned the Lease to Extell (R.20-21), and Plaintiffs did not cross-appeal the dismissal to this Court. Thus, their corporate opportunity claim is waived.

Plaintiffs' argument that Tzolis owed obligations under the Operating Agreement even after the buyout (P.Br. 1-2, 6, 9, 12, 22-23, 24-25) is based on a misreading of the relevant provision from the buyout documents. The Assignments executed by Plaintiffs state:

> Assignee Responsible for LLC Obligations. The Assignee agrees that the Assignee is and continues to be solely obligated and liable for any and all obligations and liabilities of the Assignee pursuant to the LLC Operating Agreement; and the Assignee further agrees to hold Assignor harmless from each and every liability, claim,

> cost, and expense (including, without limitation, reasonable attorney's fees and disbursements), of Assignor relating to the LLC or the Lease or the premises subject to the Lease, including, without limitation, any and all obligations and liabilities of Assignor under the LLC Operating Agreement, whether accruing before or after the Effective Date.

R.117 ¶7, R.122 ¶7. Read in full and viewed in context (as opposed to the three-line snippet quoted at P.Br. 12), the above passage is a standard "hold harmless" clause. It provides that, after the buyout, Tzolis (a) will continue to have the LLC satisfy its obligations and liabilities; (b) will be solely responsible for LLC-related liabilities that might otherwise fall on the Plaintiffs; and (c) will hold Pappas and Ifantopoulos harmless from any claims over LLC-related or Lease-related obligations.

The clause did *not* create or preserve duties running from Tzolis to Pappas and Ifantopoulos in the Operating Agreement. After the buyout, Pappas and Ifantopoulos did not have *any* rights under the Operating Agreement because the Assignments transferred 100% of their interests in the LLC to Tzolis. *See* R.116 ¶E, R.117 ¶¶2-3, R.120, R.121 ¶E; R.122 ¶¶2-3, R.125. The provision quoted above simply ensured that Pappas and Ifantopoulos would not face any continuing LLC-related liabilities after the buyout.

C. The Certificate was not void.

Plaintiffs' main opposition to Tzolis' appeal seemingly is that the Certificate became void because the buyout was not timely accomplished. *See* P.Br. 2, 9-11. The contention is spurious.

First, although the Assignments originally provided that they would become void if the "Effective Date" had not occurred by February 5, 2007, the parties *amended* the Assignments and *extended* that date to March 12, 2007. Their "Estoppel Agreement" 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. The assignment of all LLC membership interests closed on February 20, 2007 (R.57 ¶¶21-23); consequently, it was fully effective.

Second, Plaintiffs urge that the Certificate "specifically states" it applies only to transactions conducted on January 18, 2007, and not to "any other documents that were executed and delivered before or after" that date. P.Br. 9. The Certificate says nothing of the kind. Although it is dated January 18, 2007, the Certificate's application is not limited to the day it was signed. Rather, the Certificate states that it applies "*in connection with* their [Pappas' and

Ifantopoulos'] respective assignments to Steve Tzolis of their membership interests in Vrahos LLC." R.126. Whenever those assignments occurred – whether on January 18, February 20, or some other date – the Certificate applied "in connection with" them. That construction makes sense: although the Certificate and the Assignments were signed and dated on January 18 (*see* R.116, 121, 126), the parties did not know when exactly the closing would occur (*see* R.118 ¶9, R.123 ¶9).

Plaintiffs themselves recognize that the buyout took more than one day to accomplish. As their brief admits, the "[p]urchase by Tzolis of the Plaintiffs' LLC interests occurred during the period from January 18, 2007 to and including February 20, 2007." P.Br. 13. That admission defeats their "timing" argument.

II. Plaintiffs Have Failed to Show a Legal Basis for The Fourth Cause of Action for Conversion.

In his Opening Brief, Tzolis argued that a claim for conversion – the unauthorized assumption of and exercise of ownership rights over another's goods – cannot apply where, as here, the parties agreed upon a negotiated buyout. D.Br. Point II. Tzolis paid Plaintiffs a total of $1.5 million for all their interests in the LLC, and became "the holder of [those interests] ... as of the Effective Date." R.117 ¶¶2-3, 118, 122 ¶¶2-3, 125. Plaintiffs acknowledged in writing "the receipt ... and sufficiency" of the consideration paid, and stated their intent to be legally

bound. *See* D.Br. 29 & portions of record cited. The fact that Plaintiffs have grown dissatisfied with the transaction's terms does not make it a conversion.

Plaintiffs respond by repeating that Tzolis had "a fiduciary duty ... to disclose" (P.Br. 26). That contention founders upon the text of the Certificate, in which Plaintiffs certified that "Tzolis has no fiduciary duty to the undersigned Sellers in connection with such assignments." R.126.

Further, regardless of whether Tzolis was a fiduciary, a claim for conversion cannot be maintained when the parties have engaged in a voluntary assignment. *See* D.Br. 27 & cases cited. Justice Gammerman correctly so held (R.43-44), and his decision should have been affirmed.

III. Plaintiffs' Fifth Cause of Action for Unjust Enrichment Fails Because the Parties' Relations Were Governed by Written Contracts.

Citing multiple decisions of this Court spanning 42 years, Tzolis argued that unjust enrichment, a quasi-contractual theory, is available only when the parties had no contract in the first place. *See* D.Br. Point III & cases cited. Here, the parties' relationship was governed by several written contracts: the Operating Agreement (R.77-89), the buyout transaction documents (R.116-126), and related agreements such as the Lease and Sublease. *See* D.Br. 31 & n.3. Plaintiffs therefore should have been barred from suing for unjust enrichment.

Plaintiffs ignore the cases cited by Tzolis and tender no contrary authority. They fail utterly to address the legal principle upon which Tzolis's argument was founded. *See* P.Br. 27. Consequently, the First Department's decision should be reversed and Plaintiffs' cause of action for unjust enrichment should be dismissed. A contrary holding would strip contract law of predictability by authorizing judges to rewrite agreements based on a dissatisfied party's argument that the original terms were not "just." *See* D.Br. 29-30 & cases cited.

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

In the buyout, Pappas and Ifantopoulos certified that they were "not relying on any representation by Steve Tzolis." R.126. In their opposition brief, however, Pappas and Ifantopoulos contend that "Plaintiffs were relying on Tzolis' representations" (P.Br. 24) and urge this Court to allow them to pursue a cause of action for fraud (P.Br. Point IV).

Numerous cases decided by this Court and the Appellate Divisions prevent parties from doing exactly what Plaintiffs seek to do here: disclaiming reliance and then suing for fraud. *See* D.Br. 32-33 and cases cited; *accord Citibank, N.A. v. Plapinger*, 66 N.Y.2d 90, 95 (1985) ("Though not the explicit disclaimer present in *Danann*, the substance of defendants' guarantee forecloses their reliance on the claim that they were fraudulently induced to sign the guarantee by the banks' oral

promise of an additional line of credit."). Plaintiffs fail to analyze, distinguish or refute that line of decisions. *See* P.Br. 28-29.

Anyway, the Operating Agreement's elimination of any "obligation of any kind" to the other LLC members (R.85 ¶11) also eliminated Tzolis's duty to disclose under the "special facts" doctrine. Plaintiffs agree with Tzolis that the "special facts" doctrine should not apply. P.Br. 29. Because the parties disclaimed reliance and fiduciary obligations, they dealt at arm's length. Plaintiffs have provided no legal basis for superimposing a duty of disclosure on this arm's length commercial transaction.

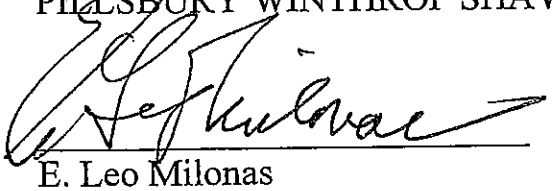
CONCLUSION

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: May 21, 2012

Respectfully submitted,

PILLSBURY WINTHROP SHAW PITTMAN LLP



E. Leo Milonas
Frederick A. Brodie
Peter Ostrovski

1540 Broadway
New York, NY 10036
(212) 858-1000

Eric S. Weinstein
Yong Hak Kim
ELLENOFF GROSSMAN & SCHOLE LLP
150 East 42nd Street
New York, NY 10017
(212) 370-1300

Attorneys for Defendant-Appellant
Steve Tzolis

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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 May 21, 2012, I served the **Reply Brief for Defendant-Appellant, dated May 21, 2012,** upon respondent's counsel herein by delivering to and leaving three true copies thereof at the office of counsel for the parties as follows:

Carl E. Person, Esq.
225 E. 36th Street
Suite # 3A
New York, NY 10016-3664

Hayley T. Allis

Sworn to before me this
21st day of May, 2012

Notary Public

ROBERT T. WESTROM
Notary Public, State of New York
No. 01-WE4919195
Qualified in Richmond County
Certificate Filed in New York County
Commission Expires Feb. 28, 2014