To be Argued by:
CARL E. PERSON
(Time Requested: 30 Minutes)

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

Court of Appeals
of the
State of New York

STEVE PAPPAS and CONSTANTINE IFANTOPOULOS,

Plaintiffs-Respondents,

– against –

STEVE TZOLIS,

Defendant-Appellant,

– and –

VRAHOS LLC,

Defendant.

BRIEF FOR PLAINTIFFS-RESPONDENTS

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Plaintiffs-Respondents Steve Pappas ("Pappas") and Constantine Ifantopoulos ("Ifantopoulos") respectfully submit this brief in opposition to the appeal by Defendant-Appellant Steve Tzolis ("Tzolis").

SUMMARY

Plaintiffs' opposition to the appeal is based on construction of § 11 of the Operating Agreement [R. 85], which does not refer to "fiduciary duties", but permits the LLC Members to engage in businesses whether or not they compete with the LLC's business of developing a single property. Section 11 does not give permission for Members to develop the LLC's property outside of the Operating Agreement, and no Member is allowed to sell or contract to sell the LLC's property without permission of the two other Members [R. 85, § 10.6(b)(ii)]. Also, each Member is required under § the Operating Agreement to consult regularly with the other Members [R. 84, § 10.1].

Also, Plaintiffs' opposition is based on the invalidity of the Certificate [R. 126] for various reasons: (i) Appellant's breach of fiduciary duty including his failure to inform Plaintiffs about his negotiations with Excell, and Plaintiffs having no notice of Appellant's dishonesty or breach of fiduciary duty; (ii) the Certificate itself [R. 126] does not eliminate any liability of the Appellant under the Assignment Agreement [R. 122-123] which states in part " 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", which means that Appellant's liability for breach of fiduciary duty is not released by the Certificate; and (iii) the Certificate became null and void when the closing was not completed by February 5, 2007 [R. 123, § 9(4)] ""if the Effective Date has not occurred by February 5, 2007, then this Assignment shall be void and of no effect"; the closing could not be completed until February 20 2007 [R. 57, ¶ 21] the date Tzolis delivered to Pappas the "Consent of Landlord and Release" dated February 14, 2007. This Certificate became null and void as a result, and was never part of the closing documents created after delivery of the Consent to Pappas. See Estoppel Agreement dated February 14, 2007, which does not refer to the Certificate but amends the Assignment Agreement [R. 222-224, ¶ 1] and provides for execution and delivery of any additional instruments to carry out the purpose of the Estoppel, but did not mention the Certificate or create any new Certificate [R. 223, ¶ 2].

The arguments of the Appellant can be summarily dismissed upon deciding that Appellant breached his fiduciary duty to the Plaintiffs (with Plaintiffs unaware of Appellant's breach or dishonesty) and that the Certificate was null and void.

STATEMENT OF FACTS

A. The Parties' Business Dealings

The Operating Agreement of Vrahos LLC dated January 13, 2006 [R. 77] created Vrahos LLC, a Delaware limited liability company (the "LLC"). The stated purpose of the LLC was set forth extensively at R. 77-79 but summarily described at R. 77 as follows:

> 4. **Business of LLC; Sublease to Tzolis.** The business of the LLC shall be: (a) to enter into and perform under a lease dated January 13, 2006 of property owned by 68 & 74 Charlton Street Company, LLC ... such property being called the "Property"), ... and to operate, develop, renovate, sublease, and rent the Property, and construct improvements thereon, and to enter into any construction contract, architectural agreement, and other contracts relating thereto; ..."

The purpose of the LLC was to develop a single property, and not to engage in any type of real estate business involving anything other than that single Property. Because of this exceedingly specific business of the LLC, the Operating Agreement eliminated some but not all of the fiduciary duties that ordinarily would be owed by partners to each other and the partnership for a more general real estate or other business. Paragraph 11 of the Operating Agreement [R. 85] provided:

> 11. **Other Activities of Members**. 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.

Paragraph 11 made it clear that Pappas, Tzolis and Ifantopoulos were free to buy and sell any other real estate in the world, even if the real estate opportunities were nearby. Paragraph 11 did not say that there was no fiduciary duty as to the LLC's highly specific business of developing the Property. The "ventures and investments" referred to in Paragraph 11 were either "in competition with the LLC" or "not in competition with the LLC", but not the LLC's business itself.

This provision of permitting competition (and thereby eliminating what otherwise would be a fiduciary duty of the partners to each other and to the LLC) could not be construed to permit one partner to operate the Property both for the LLC and for himself at the same time, because of the obvious conflict of interest and breach of fiduciary relationship.

For convenience in reviewing the Operating Agreement, an extract of relevant provisions of the Operating Agreement follows:

> 4. **Business of LLC; Sublease to Tzolis.** The business of the LLC shall be: (a) to enter into and perform under a lease dated January 13, 2006 of property owned by 68 & 74 Charlton Street Company, LLC ... such property being called the "Property"), ... and to operate, develop, renovate, sublease, and rent the Property, and construct improvements thereon, and to enter into any construction contract, architectural agreement, and other contracts relating thereto; ..."
>
> 10.1. [The Members] "are hereby designated as the managers of the LLC" (the "Managers") [R. 84];

10.1. "The Managers shall consult regularly with the other Members" [R. 84];

10.6(b). "No Member or Manager shall, except with the consent of the Managers, take any of the following actions on behalf of the LLC (all of the following actions specified in this Section 10.6(b) being collectively called the 'Major Actions'): * * * (ii) ... on behalf of the LLC: * * * execute any mortgage, bond or lease; or purchase or contract to purchase, or sell any property for or of the LLC..." [R. 85];

11. **Other Activities of Members**. 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]

12. **Liability of the Members**. Except for the affirmative representations, warranties or covenants of the Members contained in this Agreement, no Member or Manager shall be liable to the LLC or to any other person or entity for any act or omission performed or omitted by such Member in good faith pursuant to the authority granted to such Member or Manager by this Agreement, other than acts of fraud, bad faith or willful tortious misconduct. The doing of an act, or the failure to do any act, by any Member or Manager, resulting in loss or damage to the LLC, if done pursuant to advice of legal or accounting counsel employed by the Managers on behalf of the LLC, shall not subject any Member or Manager to any liability to the other Members or to the LLC. [R. 85];

15. **Applicable Law**. This Agreement shall be governed and construed under the substantive laws of the State of New York. [R. 87].

The original Operating Agreement came into existence before Plaintiffs considered or approved the Sub-Lease to Tzolis and related $20,000 monthly payment [see R. 130, ¶ 11 - backdating of Operating Agreement from March 14,

2006 to January 13, 2006], and §§ 11 and 12 apply to whatever situation calls for their application. Sections 10 and 11 combined make it clear that competition with the LLC by Tzolis does not include making deals with the LLC's assets without the knowledge and consent of the Plaintiffs. Section 11 does not envision that the LLC would be part of a competing business venture with Tzolis. Competition as to any other real estate opportunities is permitted because it does not injure the business of the LLC. But taking the LLC's asset and converting it to Tzolis' use is not competition. It is the taking of a corporate opportunity and in breach of §§ 10 (and 11), for failure to get the consent of the Plaintiffs. No reasonable person would ever construe Section 11 to mean that permitted competition includes the theft of the LLC's only asset. Stealing the only asset of the LLC is not a business venture contemplated within Section 11. Tzolis could have a business venture to steal anyone's assets other than the asset of the LLC.

Section 11 above is entitled "Other Activities of Members", and indicates that the paragraph is intended to cover activities other than activities of the LLC.

Tzolis' dealing was not his investment in the LLC's property, which would have required a sale of the property to him and approval by the Plaintiffs. Nor was his dealing a business venture with the LLC, which would have required approval by the Plaintiffs under § 10.6(b). Tzolis stretches too far to try to have his theft of the LLC's property qualify as an investment or as a business venture permitted

under § 11. The transaction was not permitted because it was not a competing business. It was a theft of the LLC's property with the LLC not obtaining any share of the profit being made by Tzolis.

B. The Parties' Business Disputes Were Not Viewed as Breach of Tzolis' Fiduciary Duties

Defendant refers to business differences that existed between Tzolis and his two partners (i.e., the Plaintiffs), but these business differences never rose to the level of distrust of and perceived dishonesty by Tzolis.

Tzolis' transaction with Extell closed during August 2007 [R. 56], "to make the sale appear to be unrelated to the January, 2007 sale of Plaintiffs' interests to Tzolis" [R. 55]. Plaintiffs did not object after hearing about the Extell transaction (or at least there is nothing in the record as to any objection), but 18 months later, during March, 2009 [R. 137], after Pappas heard that Tzolis had been negotiating with Extell to sell the Property lease prior to the purchase of LLC shares owned by the Plaintiffs [R. 137, ¶ 24], the Plaintiffs met with Tzolis and accused him of wrongdoing. Pappas described this event in his opposing affidavit [R. 137], as follows:

> 25. On or about March 2009, Infantopoulos and I met with Tzolis at Vandam Diner, about one block away from the Property, and we told him what we learned about his transaction with Extell, and Tzolis' response was as follows:

> "What do you take me for....I would never do something like that....would you do this to your partners? Who ever told you is a jealous guy and he is looking to create problems for me."

Around two weeks later, I spoke to Tzolis, when he was about to take a trip to Greece to take delivery of a new yacht. Tzolis denied ever speaking to Extell before the date when I and Gus Ifantopoulos assigned our membership interests to Tzolis; and Tzolis further asserted that he had done nothing wrong.

The Plaintiffs commenced this lawsuit several weeks later.

C. The Buyout and Last-Minute, Hand-Written Certificates

1. Tzolis made 320 times his $50,000 investment.

Defendant states that the $1 million buyout for Pappas and $500,000 buyout for Ifantopoulos were 20 times what they paid for their LLC shares. Defendant fails to state, however, that Tzolis made a profit of $16,000,000 or 320 times on his $50,000 investment - 16 times as much as 20.

2. Hand-Written Certificate Was Limited in Scope and Did Not become Effective Because of a Closing Delay

On January 18, 2007, the Plaintiffs signed a "Certificate" dated January 18, 2007, at a meeting. Larry Schatz, the attorney for Tzolis, insisted at the last minute that this hand written Certificate be signed, and dictated it. [R. 134] This Certificate [R. 126] stated in part:

> Each of the undersigned Sellers (Steve Pappas and Constantine Ifantopoulos) 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.

Pappas testified in his affidavit [R. 135] that it was his understanding, and this Certificate specifically states, that it relates only to the January 18, 2007 assignments by the Plaintiffs; this Certificate therefore does not relate either to any other documents that were executed and delivered on that day, or to any other documents that were executed and delivered before or after January 18, 2007. Further, this Certificate by no means constituted a general release of all fiduciary and other obligations to Steve Tzolis. Instead, Tzolis generally remained liable for his then existing, as well as future, obligations. For example, Section 7 of the January 18, 2007 Agreement of Assignment and Assumption [R. 122-123] executed and delivered by Pappas, Tzolis, and Vrahos LLC (called the "Pappas assignment") states in part,

> The Assignee [i.e., Steve Tzolis] 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 [i.e., Steve Pappas] harmless from each and every liability, claim, cost, and expense (including, without limitation, reasonable attorneys fees and disbursements), of Assignor relating to the LLC [i.e., Vrahos 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.

Since the Effective Date did not occur by February 5, 2007, this assignment became void, pursuant to Section 9 of this assignment [R. 123].

A comparable provision was contained in the assignment [R. 121] executed by Ifantopoulos [126].

The assignments by the Plaintiffs that were dated January 18, 2007 became void as of February 5, 2007 because, pursuant to Section 9 of each assignment [R. 123], each assignment would not become effective until the "Effective Date" occurred, and each assignment would become void if the "Effective Date" did not occur by February 5, 2007 [R. 123]. Section 9 of each assignment stated that the "Effective Date" occurred upon the happening of certain events, including the payment to the Plaintiffs of the purchase price for their interests in Vrahos LLC, and the release of Pappas under the Guaranty that Pappas had delivered under the Lease [R. 123].

Because the Plaintiffs did not receive their payments, and since Pappas was not released under this guaranty, in each such case by February 5, 2007, the

assignments became void as of February 5, 2007 [R. 123]. A condition for closing was that Pappas receive a release of his guaranty to the landlord of the LLC's lease, which occurred on February 20, 2007 [R. 57, ¶ 21].

A subsequent Estoppel Agreement dated February 14, 2007 among Pappas, Ifantopoulos and Tzolis (the "Estoppel Agreement"), attached as Exhibit C [R. 222], provides that "March 12, 2007" was substituted for "February 5, 2007" in each assignment. However, this Estoppel Agreement makes no reference to the above Certificate, which ceased to have any effect when the January 18, 2007 assignments became void, because the Certificate failed to state that it would apply to any future documents. Further, the Estoppel Agreement [R. 222], which specifically amended the assignments, failed to amend or make any reference to the Certificate.

3. Hand-Written Certificate Specifically Preserved Any Liability of Tzolis under the Operating Agreement

The Certificate [R. 126] provides in relevant part:

> 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.

The assignment [R. 122-123] provides in relevant part:

> The Assignee [i.e., Steve Tzolis] 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; ....

Accordingly, the Certificate did not extinguish the fiduciary obligations of Tzolis under the Operating Agreement.

4. Hand-Written Certificate Was Presented to the Plaintiffs without Disclosure by Tzolis in Violation of his Fiduciary Duty

In their Complaint [R. 55-56], the Plaintiffs allege:

> 15. Upon information and belief, the Certificate described in ¶ 11 above was a knowing, concerted, fraudulent and unlawful effort by Tzolis and LLC's counsel to use their fiduciary relationship with Pappas and Ifantopoulos to induce them, unknowingly, to sign away their rights as Members of the LLC to participate in the extraordinary increase in value of the Lease.
>
> 15A. Tzolis and LLC's attorneys, Grubman Indursky & Shire, P.C., had a fiduciary duty to inform Pappas and Ifantopoulos about the negotiations with Extell Development Company (and/or any companies related to it) and the actual value of the Lease before entering into the assignment agreements with Pappas and Ifantopoulos dated January 18, 2007, and failed to do so.
>
> 16. The Failure to Disclose was the omission of a material fact upon which Pappas and Ifantopoulos relied, reasonably, to their detriment, when deciding to sell their respective LLC interests to Tzolis.
>
> 17. Tzolis and (upon information and belief) the LLC's attorneys, Grubman and Schatz, intentionally withheld the information from Pappas and Ifantopoulos with scienter, to

induce them to sell their LLC interests to Tzolis at a price equal to about 1/6th of the actual value of their LLC interests.

18. This was intentional fraud and misrepresentation, and breach of a fiduciary duty, by Tzolis and LLC's attorneys, with the result that the sale of their LCC interests is void or voidable, and both Pappas and Ifantopoulos elect to rescind such sale and have it and subsequent related events declared null and void as of January 18, 2007 and thereafter.

D. The Lawsuit

Purchase by Tzolis of the Plaintiffs' LLC interests occurred during the period from January 18, 2007 to and including February 20, 2007 [R. 54, 56-57] and The sale of the lease by Tzolis to Extell took place on or about August 28, 2007 [R. 58].

This lawsuit was commenced on April 7, 2009 [R. 1, 74], more than 20 months after the sale of the lease to Extell, and only because Pappas learned during February, 2009 [R. 137] that assignment of the Lease to the Extell affiliate was negotiated by Tzolis with Extell before the Plaintiffs had assigned their interests in the LLC to Tzolis [R. 137]. Only after learning this did the Plaintiffs accuse Tzolis of any wrongdoing [R. 137].

Appellant, in his brief (at p. 10) incorrectly states that the First Cause of Action did not mention the Certificate [R. 126]. The First Cause of Action began at ¶ 31 of the Complaint [R. 59], and repeated and realleged ¶¶ 1-30, which referred to and quote the text of the Certificate at ¶ 11 [R. 51] and in ¶ 15 [R. 55-

56] alleged that "Upon information and belief, the Certificate described in ¶ 11 above was a knowing, concerted, fraudulent and unlawful effort by Tzolis and LLC's counsel to use their fiduciary relationship with the Plaintiffs to induce them, unknowingly, to sign away their rights as Members of the LLC to participate in the extraordinary increase in value of the Lease." Also, in ¶ 24 [R. 57], the Plaintiffs alleged that the Certificate and all other sale documents are null and void.

In Appellant's brief at p. 10, Appellant states incorrectly that the Complaint did not explain how Tzolis could be "unjustly enriched" when he was the owner of 100% of the LLC interests at the time of the sale of the Lease to Extell. In ¶¶ 57-59 the Plaintiffs allege that Tzolis's acts and unlawful activities alleged in preceding paragraphs resulted in unjust enrichment as to amount received for LLC interests "in excess of his 40% interest in the LLC" [R. 64]. The explanation was set forth in ¶¶ 25-30A of the Complaint [R. 58-59], as an "exploitation by Tzolis, for his own personal benefit, of such opportunity of the LLC" [¶ 28].

Appellant (at p. 11 of his brief) claims that the Plaintiffs did not explain how they had any claim in light of the Certificate. Plaintiffs, in their Complaint [R. 54-55] allege that the Certificate "was a knowing, concerted, fraudulent and unlawful effort by Tzolis and LLC's counsel to use their fiduciary relationship with the Plaintiffs to induce them, unknowingly, to sign away their rights as Members of the LLC to participate in the extraordinary increase in value of the Lease." [¶ 15]

Also, the Plaintiffs allege in ¶ 63(b)(ii) that the Certificate is null and void because of Tzolis' alleged activities [R. 65].

E. The Motion Court's Decision

J. H. O. Ira Gammerman, in his decision dismissing the action [R. 40-45], concluded at the outset that "paragraph 11 eliminates the fiduciary relationship that would, otherwise, be owed by the members to each other and to the LLC" [R. 41 and R 11]. This conclusion by Justice Gammerman was reached without any discussion or analysis of the interaction of ¶ 11 with other provisions in the Operating Agreement. See Plaintiffs' analysis above, at pp. 1-5.

Justice Gammerman's dismissal of the fourth count (conversion) involved a single sentence [R. 43-44], that no conversion of property can exist when a party has "willingly sold" his property.

Justice Gammerman's dismissal of the fifth cause of action (unjust enrichment) [R. 44] was based on the judicial conclusion of a willing sale and arm's length transaction, and impliedly the lack of a fiduciary relationship.

Justice Gammerman's dismissal of the tenth cause of action (fraud and misrepresentation) was based on the judicial conclusion of a lack of a fiduciary relationship [R.44].

F. The First Department's Decision

The First Department, in its decision [R. 13] held that Paragraph 11 of the Operating Agreement "does not 'clearly' permit Tzolis to engage in behavior ... to surreptitiously engineer the lucrative sale of the sole asset owned by Vrahos, without information his fellow owners of that entity" and "that Tzolis failed to meet his burden of establishing that the provisions extended that far". [R. 13] Also, the First Department pointed out that Delaware law requires an explicit elimination of traditional fiduciary duties, which was not done in the Operating Agreement [R. 14].

The First Department, in its decision [R. 14-16] held that the Certificate, when signed, did not undo the fiduciary duty owed by Tzolis prior to the signing of the Certificate, its decision in *Blue Chip Emerald v. Allied Partners*, 299 AD2d 278 (2002), that Tzolis was a fiduciary in matters relating to the venture until the moment the buy-out transaction closed, and "strictly obligated to make full disclosure of all material facts ... that could reasonably bear on ... consideration of [the fiduciary's] offer" [R 15]. ""Tzolis had an overriding duty to disclose his dealings with Extell to plaintiffs before they assigned their interests in Vrahos to him." [R16] *Accord*, citing *Blue Chip, Khan v. BDO Seidman, LLP*, 408 Ill.App.3d 564, 948 N.E.2d 132 (2011).

The decision (by the majority) went on to distinguish *Centro Empresarial Cempresa S.A. v. America Movil, S.A.B. de C.V.*, 17 NY3d 269 (2011), *affg* 76 AD3d 310 (2010) on the grounds that the sellers had been given sufficient financial information about valuation and knew that the purchaser was not being forthright [R. 17]. Also, there had been an exceedingly broad release, unlike the Certification signed by the Plaintiffs [R. 18].

The majority decision reinstated the causes of action for conversion and unjust enrichment "based on our finding that because of Tzolis's surreptitious behavior, plaintiffs did not sell their interests in Vrahos willingly or at arm's length." [R. 20]

ARGUMENT

THE FIRST DEPARTMENT WAS CORRECT 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 IN CLOSING DOCUMENTS THAT THE BUYER HAD "NO FIDUCIARY DUTY" TO THEM AND THEY WERE "NOT RELYING ON ANY REPRESENTATION" BY THE BUYER

I. The Operating Agreement Did Not Eliminate the Members' Fiduciary Duties to Each Other

It should be noted that a decision permitting partners to surreptitiously steal from each other would render obsolete hundreds of thousands of partnerships and

partnership agreements, and create a Wild, Wild West scenario for partnerships in the United States.

Section 11 of the Operating Agreement [R. 85] cannot be construed to eliminate fiduciary duties of the LLC Members as to the business of the LLC in developing a single property. See discussion above at pp. 1-5. Delaware law requires an explicit provision in the Operating Agreement to eliminate traditional fiduciary duties the members otherwise owe to each other. There was no such explicit provision in § 11 [R. 85], which states:

> 11. **Other Activities of Members**. 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.

Because there is no explicit provision eliminating traditional fiduciary duties, and because a reading of § 11 shows that it does not even mention fiduciary duties or that they do not apply to members when dealing with the LLC's business and single property, § 11 cannot be construed to eliminate fiduciary duties of the LLC Members as to each other or as to the LLC.

A recent Delaware decision reaffirms the "default fiduciary duties" of LLC managers under Delaware law even when an agreement exists purporting to eliminate fiduciary duties of the managers. *Auriga Capital Corp. v. Gatz Properties, LLC*, --- A.3d ----, 2012 WL 361677 *2 (Del. Ch. January 27, 2012) ("this court, have consistently held that default fiduciary duties apply to those

managers of alternative entities who would qualify as fiduciaries under traditional equitable principles, including managers of LLCs").

Centro, supra, p. 15 is distinguishable and not applicable because the fiduciary relationship remained one of unquestioned trust, with no notice of any dishonesty; there was no indication that Tzolis was acting in his own interests as to any third-party transaction involving the LLC's only property; and there was no broad release involved. In fact, the Certificate was so limited that it became null and avoid, and by its terms did not eliminate any liability of Tzolis under the Operating Agreement.

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.), cited by Tzolis in his brief at p. 19, is distinguishable because the provision disclaiming any fiduciary relationship was clear and unambiguous, that "Nothing herein contained shall be construed to place the parties in the relationship of partners, joint ventures, principal and agent, or fiduciaries...". In the instant case, there is no such clear and unambiguous disclaimer. Section 11 does not even refer to fiduciary duty, and at best is a limitation of fiduciary duties among the Managers that was created with the

Operating Agreement. The limitation related to other businesses in which the Members may be engaged.

The First Department, in its decision, was fully aware of the reference to *Blue Chip* in *Centro*, stating [R. 18-19]: "it is irrelevant here. ... Here, the dissent points to no evidence that plaintiffs and Tzolis were not still in a relationship of unquestioning trust at the time of the transaction at issue, other than employing the circular logic that they must not have had such a relationship given that plaintiffs were willing to execute the certificate." Also, the First Department "certifies that its determination was made as a matter of law and not in the exercise of discretion" and that "the following question of law, decisive of the correctness of its determination, has arisen, which in its opinion ought to be reviewed by the Court of Appeals" [R. 3].

A. As a matter of law, Tzolis did not show that there was no longer "unquestioning trust" in Tzolis.

The Certificate is not evidence of lack of unquestioned trust, and could have been signed because of the existence of unquestioned trust. There is no showing of any facts to put the Plaintiffs on notice as to having insufficient financial information or as to the existence of any potential transaction involving the LLC's only property.

Plaintiffs' pleading does not show any lack of trust or dishonesty during the period preceding the buyout. Disagreement among partners does not mean

dishonesty. The partnership disagreements resulted in sub-leasing the property to Tzolis, but not because of any dishonesty or breach of fiduciary duty. The sub-leasing continued the fiduciary relationship, which is an indication at that time that the plaintiffs were unaware of any dishonesty or breach of fiduciary duty by Tzolis.

Section 11 [R. 85], permitting each of the Managers (i.e., partners) to engage in real estate and other ventures even if in competition with the business of the LLC, was no reason to distrust any of the partners as to the management of the LLC's business (relating to a single piece of property). This is not a situation where the LLC was looking for additional properties to acquire. Thus, the dual interest found in *Everett v. Phillips*, 288 N.Y. 227, 236-37 (1942) does not exist in the instant appeal.

B. The LLC Had a Continuing Interest in the Lease, with the Right of the 3 Managers to Approve any Sale of the Lease; Tzolis Had a Sub-Lease with No Right to Sell or Re-Lease to Anyone other than an Affiliate

Tzolis could assign or sub-lease his Sub-Lease Agreement to entities he controlled, but he could not do so to third parties without the consent of the Plaintiffs.

Tzolis' brief states (at p. 23) that the Tzolis sub-lease dated June 16, 2006 (the "Sub-Lease", R 58) was the only asset of the LLC. This is not true. Tzolis was given the Sub-Lease with strings attached, to ensure that all partners participated in any sale or lease of the property to a non-affiliated third party. This was the main asset of the LLC. The most important controlling string in the Operating Agreement was that Tzolis had the right to sub-lease or assign the Sub-Lease only to entities controlled by him [R. 102]. Any other assignment or sub-lease of the Sub-Lease required the consent of the Sublandlord (meaning through the consent of the Plaintiffs) [R. 102]. The purpose of this provision was to ensure that any transfer of the Sub-Lease (through assignment or sub-lease) to any third party would not occur without disclosure to and approval by the Plaintiffs [R. 102].

To ensure that Vrahos had a reversionary interest in the property subject to the Sub-Lease, the Sub-Lease was carefully crafted to have duration shorter than Vrahos' interest [R. 93], "not later than December **30**, 2054" as to the Sub-Lease and [R. 142-143], "48 years, 11 months and 18 days" from "January 13, 2006" or December **31**, 2054.

Thus, Tzolis did not obtain in his Sub-Lease all of the interest possessed by the LLC. The interest of the LLC, Pappas and Ifantopoulos was protected by the provision requiring Tzolis to obtain the consent of his two members (i.e., Pappas and Ifantopoulos) if he assigned, sold, sub-leased or

otherwise disposed of the Sub-Lease to any third party (see ¶ 8, "Assignment and Subletting", R. 102, and ¶ 5.5, R. 100).

Tzolis' argument that he was the only asset and therefore a debtor of the LLC instead of a fiduciary to the LLC and its other two Members is a false, misleading and dilatory argument. If Tzolis failed to pay the Sub-Lease rentals, the Sub-Lease could be terminated and the Lease sold or sub-leased to a non-affiliated third person (for millions of dollars, as we now see what happened).

The buyout was not the sale of the two partners' 60% percentage interest in a stream of $20,000 monthly payments (after providing for payment to the Landlord under the original 49-year lease. It was the sale of the existing sub-lease and any potential sale or lease of the property which might have occurred over the 48-year period of the sub-lease.

At p. 24 of Appellant's brief, there is a statement about superimposing fiduciary duties on ordinary business relationships. This is another dilatory, inappropriate argument. The creation of an Operating Agreement for investing in a piece of real estate (49-year lease) is not an ordinary business relationship, and the Delaware laws provide for the automatic creation of fiduciary duties, in absence of an explicit provision which eliminates traditional fiduciary duties. Here, in the instant case, there was no explicit provision removing the statutory fiduciary

duties, and the case has nothing to do with "superimposing fiduciary duties on ordinary business relationships".

C. Plaintiffs were relying on Tzolis' representations

By having no warning of Tzolis' dishonesty or breach of fiduciary duty in their pre-buyout dealings with Tzolis, the plaintiffs were relying on Tzolis's actions as representations of his honesty and adherence to fiduciary duties. The Certification signed by the plaintiffs for use in the closing was signed because of the lack of any notice of dishonesty or breach of fiduciary duty and the lack of any financial information indicating the transaction with Extell, and the breach of duty by Tzolis to update his partners on his negotiations with Extell was in violation of § 10.1 and 10.1(6)(b) of the Operating Agreement and a breach of fiduciary duty by Tzolis. These provisions state:

> 10.1. "The Managers shall consult regularly with the other Members" [R. 84];
>
> 10.6(b). "No Member or Manager shall, except with the consent of the Managers, take any of the following actions on behalf of the LLC (all of the following actions specified in this Section 10.6(b) being collectively called the 'Major Actions'): * * * (ii) … on behalf of the LLC: * * * execute any mortgage, bond or lease; or purchase or contract to purchase, or sell any property for or of the LLC…" [R. 85];

Plaintiffs were justified in relying on the lack of any information from Tzolis about his dealings with Extell because as a fiduciary he had the duty of reporting such negotiations, and was also precluded from contracting to sell any property of the LLC. Plaintiffs had no way of knowing that Tzolis was in breach of his fiduciary duties when signing the Certificate. *Centro* does not change this conclusion of law under these facts.

D. The Certificate's disclaimer is not effective as a release of Tzolis's fiduciary duties to the Plaintiffs

The Certificate never came into effect and if it came into effect did not eliminate Tzolis's liabilities for breach of the Operating Agreement, as explained at pp. 7-9 above.

Also, even if it came into effect for the limited purpose of disclosures at the closing table, it did not release Tzolis from his breaches of fiduciary duty of disclosure of his dealings with Extell for the 2-month or longer period prior to the closing [R. 137, ¶ 24], from no later than Thanksgiving, 2006 to January or February, 2007.

Also, the Certificate never came into effect because there was no reason for the Plaintiffs to conclude from past activities that Tzolis was dishonest and had breached any of his fiduciary duties to the Plaintiffs.

The Plaintiffs have sufficiently alleged breach of fiduciary duty by Tzolis.

II. The Complaint States a Cause of Action for Conversion

In its decision, the First Department stated [R. 20]:

> As for plaintiffs' causes of action for conversion and unjust enrichment, we reinstate them based on our finding that, because of Tzolis's surreptitious behavior, plaintiffs did not sell their interests in Vrahos willingly or at arm's length. Plaintiffs are entitled to litigate their claims that Tzolis's wrongful behavior constituted a conversion of a portion of their interests in Vrahos and that equity dictates that Tzolis return the corresponding value to them.

Appellant's argument (brief, pp. 27-28) is based upon the lack of a fiduciary duty of Tzolis to disclose facts to the plaintiffs. However, it is clear that there had been a fiduciary duty of Tzolis to disclose, so that Tzolis's argument concerning conversion should be disregarded, and the First Department's decision upholding plaintiffs' (fourth) cause of action for conversion should be affirmed.

The parties had not been dealing at arm's length because of the breach of fiduciary duty, and the Certificate did not change this result, for the various reasons about the invalidity of the Certificate stated above (at pp. 1-2, 8-11).

The First Department's statement about "surreptitious behavior" was in the context of a person having and breaching a fiduciary duty, and Appellant's reference to "surreptitious behavior" at brief p. 29 is a false and misleading argument.

III. The Cause of Action for Unjust Enrichment is Not Defeated by Documentary Evidence

In its decision, the First Department stated [R. 20]:

> As for plaintiffs' causes of action for conversion and unjust enrichment, we reinstate them based on our finding that, because of Tzolis's surreptitious behavior, plaintiffs did not sell their interests in Vrahos willingly or at arm's length. Plaintiffs are entitled to litigate their claims that Tzolis's wrongful behavior constituted a conversion of a portion of their interests in Vrahos and that equity dictates that Tzolis return the corresponding value to them.

The document creating the unjust enrichment is the Certificate, created through Tzolis's surreptitious behavior. By not enforcing the Certificate as a bar to recovery, the plaintiffs' cause of action for unjust enrichment was upheld.

Appellant, to avoid the effect of this argument, bring in (at brief p. 31) other documents, including "the Operating Agreement (R. 7-89), ... 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)."

These other documents did not create the unjust enrichment, only the Certificate, which document (as an agreement) was not enforced, and with unenforceability of the Certificate there is the Plaintiffs' claim for unjust enrichment.

IV. There is No Documentary Evidence Barring the Cause of Action for Fraud and Misrepresentation

In its decision, the First Department stated [R. 19-20]:

> Accordingly, we conclude that the motion court erred in dismissing plaintiffs' claims for ... fraud. With respect to the latter cause of action, we note that while the complaint's allegations, insofar as they were made upon information and belief, may have been insufficient, plaintiffs cured any defect by making particular allegations of fraud in Pappas's affidavit in opposition to the motion (see *Cron v. Hargro Fabrics*, 91 NY2d 362, 366 [1998]). The dissent contends that the fraud and misrepresentation claim should be dismissed because "Pappas and Ifantopoulos did not ask Tzolis why he was offering them 20 times more than what they had invested in Vrahos one year earlier." However, the dissent is ignoring the basic precepts that must be followed on a motion to dismiss and applying a standard that is more suitable to summary judgment. Accepting the facts as alleged as true and according plaintiffs the benefit of every possible favorable inference, we find that plaintiffs have alleged enough to permit them to develop a full record on the issue whether they acted reasonably.

Appellant bases his argument, once again, on assumed enforceability of the Certificate (Brief, p. 32, 1st para.) and an assumed duty to disclose (Brief, p. 33, 1st full para.) and an assumption that Section 11 [R. 85] of the Operating Agreement eliminates any fiduciary duty (Brief, p. 33, 2nd full para.).

At Brief p. 34, Appellant argues disingenuously that "the value of Pappas's and Infantopoulos's [sic] 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."

The real value ($17,500,000 to be paid by Extell) [R. 58, ¶ 25] was known only to Tzolis, and was peculiarly within Tzolis's knowledge, which he failed to share with the Plaintiffs, in breach of his fiduciary duty.

The knowledge that Tzolis acquired about the upside value of the leasehold should have been disclosed to the Plaintiffs, but was not.

Plaintiffs had no duty to inquire at or before the closing because they had no notice of any dishonesty or breach of fiduciary duty by Tzolis.

There is no application of the "special facts" doctrine because of the breach of fiduciary duty by Tzolis.

Accordingly, the decision of the First Department as to the tenth cause of action for fraud and misrepresentation should be upheld.

CONCLUSION

For all of the foregoing reasons, the decision of the Appellate Division, First Department should be affirmed.

Dated: May 1, 2012

Respectfully submitted,

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