STATE OF NEW YORK
SUPREME COURT: COUNTY OF ERIE

UNIVEST I CORP., derivatively on behalf of
470 PEARL STREET, LLC,

Petitioners, Index No. 811644/2014

v.

SKYDECK CORPORATION d/b/a PAY2PARK,
BUFFALO DEVELOPMENT CORPORATION, and
Nominal Respondent 470 PEARL STREET, LLC

Respondents.

MEMORANDUM OF LAW IN SUPPORT TO RESPONDENT'S MOTION FOR PERMISSION TO REARGUE

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PRELIMINARY STATEMENT

Univest I Corp. ("Univest" or "Petitioner") brought a Petition pursuant to Article 7 of the Real Property Actions and Proceedings Law (RPAPL) derivatively in the name of 470 Pearl Street, LLC. The litigation was commenced without the consent of Buffalo Development Corporation ("BDC") (Exhibits 1 and 3). Buffalo Development Corporation moved to dismiss the Petition as unauthorized and a breach of the members' contract (Exhibit 2). The Court denied the Motion to Dismiss in a Decision and Order dated November 26, 2014 and entered on December 1, 2014 (Exhibit 2).

BDC now moves this Court for leave to reargue the Motion to Dismiss.

a. Motion for Leave to Reargue

A motion for leave to reargue is appropriate to determine if the court has "overlooked or misapprehended" a point of law. NY CLS CPLR R 2221.

This Motion for Leave to Reargue argues that the court overlooked the limitations of derivative actions in a Limited Liability Company setting. The parties by contract limited the right to commence litigation in the name of the LLC by requiring consent of a majority of the members. Consent was not sought nor obtained in this case.

The Court of Appeals established, in general, that derivative actions are allowed in the Limited Liability Company context. At the same time, the Court of Appeals recognized limitations to the use of derivative actions. BDC believes that this Court incorrectly concluded that a derivative action was appropriate here by overlooking the parties' contractual limitation to commencing suit. Such a negotiated agreement is an appropriate limitation on derivative actions.

BDC requests that the Court allow reargument and upon further consideration dismiss the

Petition based on the limitation on commencement of litigation found in the parties' Operating Agreement. Alternatively, BDC requests that the Court amend the relief granted to postpone the effective date until 30 days after the parties agree on a tenant for the property.

b. Motion to Dismiss

Respondent Buffalo Development Corporation brought the Motion pursuant to CPLR 3211(a)(1) to dismiss the proceeding based on documentary evidence (N.Y. CVP. LAW § 3211).

The documentary evidence is the parties Operating Agreement.

As set forth in the Affirmations of Robert E. Knoer dated October 16, 2014 (Exhibit 2) and December 30, 2014 attached and the Affidavit of Mark D. Croce sworn to October 16, 2014 (Exhibit 2) with exhibits attached thereto and the Memorandum of Law filed in support to the Motion, it is respectfully submitted that the Verified Petition should be dismissed pursuant to CPLR 3211(a)(1) on the basis that the Operating Agreement, as a binding contract, prohibits unilateral legal action by one member in the name of the LLC.

c. The Right to Commence Derivative Claims Can Be Limited

Courts have recognized common law rights of trust beneficiaries, shareholders, and now members of a Limited Liability Company to commence actions in the name of the entity to enforce the rights of the entity.

The origins of common law derivative rights are based in equity. Courts were concerned that no remedy would be available to redress a breach of fiduciary duty, fraud or other wrongs against a shareholder.

As the Court of Appeals explained in *Tzolis*:

> "The derivative suit has been part of the general corporate law of this state at least since 1832. It was not created by statute, but by case law. Chancellor Walworth recognized the remedy in Robinson v Smith (3 Paige Ch 222 [1832]), because he thought it essential for shareholders to have recourse when those in control of a

> corporation betrayed their duty. Chancellor Walworth applied to a joint stock corporation--then a fairly new kind of entity--a familiar principle of the law of trusts: that a beneficiary (or "cestui que trust") could bring suit on behalf of a trust when a faithless trustee refused to do so. Ruling that shareholders could sue on behalf of a corporation under similar circumstances, the Chancellor explained: "The directors are the trustees or managing partners, and the stockholders are the *cestui que trusts*, and have a joint interest in all the property and effects of the corporation... . And no injury the stockholders may sustain by a fraudulent breach of trust, can, upon the general principles of equity, be suffered to pass without a remedy. In the language of Lord Hardwicke, in a similar case [Charitable Corp. v Sutton, 2 Atk 400, 406 (Ch 1742)], 'I will never determine that a court of equity cannot lay hold of every such breach of trust. I will never determine that frauds of this kind are out of the reach of courts of law or equity; for an intolerable grievance would follow from such a determination.' " [**1007] (3 Paige Ch at 232.)
>
> *Tzolis v. Wolff*, 10 N.Y.3d 100, 103-104 (N.Y. 2008)

BDC and Univest agreed in direct negotiations as part of a larger bundle of rights and responsibilities that litigation in the name of the LLC could only be commenced upon consent of a majority of the members. There is no public policy or statutory basis to deny the requirement of consent to litigation.

STATEMENT OF FACTS

The lease between 470 Pearl Street, LLC and Skydeck Corporation was terminated by Order of this Court dated September 26, 2014. Thereafter Skydeck was not a holdover tenant but rather was in possession of the property pursuant to the terms of the interim order of the court. Univest sought to amend that interim relief by a Petition pursuant to RPAPL 7. Buffalo Development Corporation does not dispute that the lease was terminated. The question facing the LLC now, as it was at the preliminary injunction, is whether to remove Skydeck prior to a resolution of the parties' dispute as to operation of the property pending the anticipated development. Both parties recognize that such an action is not in the company's best interest.

Even Univest asserted in the Petition here:

> "36. An RFP process, whether the proposed RFP attached as Exhibit I or another RFP crafted by the Court or the parties, will provide a substantial economic benefit to the LLC and will keep the Parking Lot open and available to the public during the process. If the Court grants this petition, petitioner will not displace Skydeck from the Parking Lot until after the RFP process plays out and a new tenant is identified, ready, willing and able to step in and operate the lot." *(Emphasis added)*

Paragraph 36 of the Verified Petition (Exhibit 1).

The Members agreed that the Operating Agreement they entered would supersede any other provision of the Limited Liability Company Law as far as allowed.

Section 2.01 Formation; Admission.

> 470 Pearl was formed as a limited liability company under the provisions of the Limited Liability Company Law by the filing on December 27, 2004 of the Articles of Organization with the Secretary of State of the State of New York. Each of the Members listed on Schedule I of this Agreement has been admitted to 470 Pearl as a Member. The rights and liabilities of the Members are as provided in the Limited Liability Company Law, except as is otherwise expressly provided in this Agreement.

Operating Agreement Section 2.01

The parties through counsel, negotiated numerous rights and obligations related to the management and operation of the LLC (Exhibit 1 (Exhibit E, page 5)). Those terms included the requirement of consent of a majority of the members to institute litigation in the name of the LLC.

Section 6.02 Events Requiring the Vote, Consent or Approval of the Members.

Any Member has the right, without the consent or approval of any other Member or Members, to cause 470 Pearl to terminate a certain Parking Lease entered into between 470 Pearl and Skydeck Corporation pursuant to the termination provisions of said lease.

The Manager must, in addition to any other vote, consent or approval required by or under the Limited Liability Company Law, obtain the vote in favor of, consent to, or approval of a Majority in Interest of the Members before he may cause or permit 470 Pearl to take any action with respect to any events or matters set forth in the Management Agreement as requiring 470 Pearl's approval or any of the following events or matters:

....

(h) Cause or permit 470 Pearl to (i) commence, prosecute, defend or settle any claim, action or proceeding of any nature by or against 470 Pearl, or (ii) confess a judgment against 470 Pearl;

Operating Agreement 6.02

Regardless of who the Manager is, the only reasonable interpretation of this provision is that the parties contractually agreed not to commence litigation in the name of the LLC without the consent of a majority of the members.

The Limited Liability Company Law encourages members to negotiate the "rights, powers, preferences, limitations or responsibilities" of the members.

§ 417. Operating Agreement

(a) Subject to the provisions of this chapter, the members of a limited liability company shall adopt a written operating agreement that contains any provisions not inconsistent with law or its articles of organization relating to (i) the business of the limited liability company, (ii) the conduct of its affairs and (iii) the rights, powers, preferences, limitations or responsibilities of its members, managers, employees or agents, as the case may be.

NY CLS LLC § 417.

470 Pearl Street, LLC negotiated the members' rights and the Agreement should be enforced.

ARGUMENT

I. THE 470 PEARL STREET, LLC OPERATING AGREEMENT IS A CONTRACT AND SHOULD BE ENFORCED AS SUCH

New York Limited Liability Company Law establishes that members are free to determine the rights and obligations of membership in a negotiated Operating Agreement. An Operating Agreement is a contract and should be enforced as such.

The Fourth Department has held that "It is well settled that a "written agreement that is complete, clear and unambiguous on its face must be enforced according to the plain meaning of its terms" (*Greenfield v. Philles Records*, 98 N.Y.S.2d 562, 569, 780 NE2d 166, 750 N.Y.S.2d 565 [2002]; see *W.W.W. Assoc. v. Giancontieri*, 77 N.Y.S.2d 157, 162, 566 NE2d 639, 565 N.Y.S.2d 440 [1990])." *Davies v. Jerry*, 966 N.Y.S.2d 797, 798 [4th Dept. 2013].

Courts interpreting an Operating Agreement will apply general contract principles to interpret, not rewrite, the parties' agreement (see *In re Matco-Norca, Inc.*, 802 N.Y.S.2d 707, 708-709 [2d Dept 2005] [interpreting shareholder agreement]:

> "Further, a court may not write into a contract conditions the parties did not insert by adding or excising terms under the guise of construction, nor may it construe the language in such a way as would distort the contract's apparent meaning (see Tikotzky v City of New York, 286 A.D.2d 493, 729 N.Y.S.2d 525 [2001]; Slamow v Delcol, supra at 727; Tantleff v Truscelli, 110 A.D.2d 240, 244, 493 N.Y.S.2d 979 [1985], affd 69 N.Y.S.2d 769, 505 NE2d 623, 513 N.Y.S.2d 113 [1987]). The words and the phrases used in an agreement must be given their plain meaning so as to define the rights of the parties (see Laba v Carey, 29 N.Y.S.2d 302, 308, 277 NE2d 641, 327 N.Y.S.2d 613 [1971]; Levine v Shell Oil Co., 28 N.Y.S.2d 205, 212-213, 269 NE2d 799, 321 N.Y.S.2d 81 [1971]).
>
> *In re Matco-Norca, Inc.,* 22 A.D.3d 495, 496 (N.Y.S. App. Div. 2005)

See also: *Switzer v. 1236 Restaurant LLC*, 2008 N.Y. Misc. LEXIS 10719 at 6-7 [S. Ct. N.Y. Co. 2008]; *Petrakis v. Rose*, 2006 N.Y. Misc. LEXIS 2173 at7-8 [S. Ct. Nassau Co. 2006]). A comprehensive, well-drafted operating agreement reflecting the parties' entire understanding

is binding on the parties, and will be enforced according to its terms (see generally, LLCL §§ 4.01, et seq.; *In re Penepent Corp.*, 96 N.Y.S.2d 186, 192 [2011];

> The court in *Penepent* reinforced that "[a]s a general rule, courts must enforce shareholder agreements according to their terms (see, *Gallagher v. Lambert*, 74 N.Y.S.2d 562, 567 (1989)). Such agreements avoid costly, lengthy litigation (see, *Allen v. Biltmore Tissue Corp.*, 2 N.Y.S.2d 534, 542-543, 161 N.Y.S.2d 418, 141 NE2d 812 (1957) and promote "reliance, predictability and definitiveness" in relationships among shareholders in close corporations (*Gallagher v. Lambert*, supra). *Id.* See also *Ahmed v. Fulton St. Bros. Realty, LLC*, 68 N.Y.S.2d 523, 525 [2d Dept 2013]; *Verderber v Commander Enters. Centereach, LLC*, 925 N.Y.S.2d 142, 144 [2d Dept 2011]).
>
> *Greenberg v. Greenberg*, 37 A.D.3d 410, 411 (N.Y. S. App. Div. 2d Dep't 2007)

The members of the LLC contemplated that any litigation would require consent by a majority of the members. They memorialized that in the Operating Agreement. That intention should be honored and this proceeding dismissed.

Univest is requesting that the Court provide them a right as a member that was not negotiated for, and in fact is in direct opposition to, the specific terms of the Operating Agreement. The Fourth Department has recognized the enforceability limitations on litigation as between business partners.

> "We agree, however, with defendant that Supreme Court erred in failing to grant his motion to dismiss the complaint against him by plaintiff. The partnership agreement provided that, except in the ordinary course of business, no litigation may be commenced unless there is an affirmative vote of 75% of the partnership interests. It is undisputed that the present action was not commenced in the ordinary course of business and was approved by a vote of only 55.45% of the partnership interests. The partnership agreement therefore bars the partnership from commencing the present action against defendant. Because the detailed partnership agreement is a complete expression of the partners' intentions, we cannot, as plaintiff suggests, rewrite the agreement to disqualify defendant from voting on this partnership decision.
>
> Consequently, we modify Supreme Court's order by granting defendant's motion to dismiss the complaint against him by plaintiff."

Heritage Co. v. La Valle, 199 A.D.2d 1036, 1036-1037 (N.Y. App. Div. 1993)

II. MANAGEMENT OF 470 PEARL STREET, LLC

As Manager, BDC is responsible for "[c]ompany management" and "holds office until the earliest to occur of his resignation, removal for cause, withdrawal from [the LLC], disability or death" (Id. at §§ 6.01 [a], 6.03). "Cause" is defined as a failure to perform material obligations set forth in the OA or the Limited Liability Company Law or to cure the defect, "an act of fraud, theft or dishonesty" against the LLC, or a felony conviction (Id. at § 6.04).

Univest does not allege any act of "fraud, theft or dishonesty" by BDC as a basis for the Petition. The proceeding to amend the interim relief provided in the Court's Order of September 26, 2014 disguised as an RPAPL Article 7 request to recover possession of real property, is an attempt by Univest to have the Court intervene in the internal affairs of the LLC and provide Univest with powers that were not granted in the Operating Agreement.

The Operating Agreement is an indivisible integrated whole. Univest cannot pick and choose the parts it wants to keep and the parts it no longer likes. Univest should be made to fulfill all of the unambiguous negotiated obligations of the Operating Agreement and be bound by the agreed to limitations.

III. DERIVATIVE PROCEEDINGS IN THE CONTEXT OF LIMITED LIABILITY COMPANY

A. Derivative Rights as a Common Law Remedy

The Court of Appeals in *Tzolis v. Wolff* revisited the purpose and role of derivative claims in a corporate setting. Over 100 years ago the Court determined there should be a remedy to any breach of trust or fraud in the corporate context. Members of a stock corporation should be able

to redress such wrongs committed by those running the corporation. As the Court of Appeals quoted:

> "The directors are the trustees or managing partners, and the stockholders are the *cestui que trusts*, and have a joint interest in all the property and effects of the corporation... . And no injury the stockholders may sustain by a fraudulent breach of trust, can, upon the general principles of equity, be suffered to pass without a remedy. In the language of Lord Hardwicke, in a similar case [Charitable Corp. v Sutton, 2 Atk 400, 406 (Ch 1742)], 'I will never determine that a court of equity cannot lay hold of every such breach of trust. I will never determine that frauds of this kind are out of the reach of courts of law or equity; for an intolerable grievance would follow from such a determination.' "(3 Paige Ch at 232.)
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> *Tzolis v. Wolff*, 10 N.Y.3d 100, 104 (N.Y. 2008).

The underlying purpose of derivative claims is to address a breach of fiduciary duties, fraud and other wrongs by those in a position of power within a corporate, trust or partnership structure. It is not meant as an alternative to the normal operations of a business entity.

IV. *TZOLIS* IS DISTINCT FROM 470 PEARL STREET, LLC

There are several distinctions between the facts and legal issues in *Tzolis* and this case. First, *Tzolis* did not consider an Operating Agreement which specifically addressed the rights to institute litigation (for an explanation of the facts underlying *Tzolis,* see generally *Tzolis v. Wolff*, 12 Misc. 3d 1151(A); 819 NYS 2d 852 (Sup. Ct. NY City 2006). 470 Pearl Street, LLC's Operating Agreement very specifically addresses limitations on commencing litigation.

Second, there was no indication in *Tzolis* of a dispute resolution mechanism agreed to by the parties. The absence of any other remedy in the face of fraud or a breach of trust is the basis for the equitable relief fashioned as a derivative claim. There has been no allegation of fraud or a breach of fiduciary duty in the Petition here. Furthermore, 470 Pearl Street, LLC has a dispute resolution mechanism that was negotiated at arm's length between the parties providing a

remedy. There is no chance in the 470 Pearl Street, LLC scenario that "a fraudulent breach of trust can, upon the general principles of equity, be suffered to pass without a remedy" (*Tzolis v. Wolff id.* at page 103).

There is No Basis for a Derivative Claim on these Facts

Derivative claims are meant as a last resort to redress an otherwise un-redressed fraud or breach of trust; not to provide additional rights to one member of a two member Limited Liability Company.

Univest I Corp. alleges that Buffalo Development Corporation, acting as the appointed Manager of 470 Pearl Street, LLC will not remove Skydeck Corporation as a holdover tenant. Skydeck is not a holdover tenant but rather occupies the property based on an Order of the Court dated September 26, 2014. As this Court has recognized the operation of the property while awaiting development of the property is a matter for resolution by the parties. "It is not the Court's role to manage the LLC for the members" (Exhibit 4, Decision and Order dated November 26, 2014 page 9).

BDC's decision not to remove the only source of income that the LLC has while the members determine how to proceed is certainly not a basis for a claim of fraud, breach of fiduciary duty, or any equitable wrong doing. It is simply a business decision. The right business decision for the LLC and its members.

To support a derivative claim, Univest must not only assert that BDC disagrees or refuses to act, but that the disagreement or refusal to act is wrongful, and constitutes a fraud or breach of a duty. There is no such allegation here. There can be no allegation here. BDC believes that

until the members have reached an agreement as to how the property will be operated, it is inappropriate to throw out the only source of revenue the entity currently has.

This is not an issue of "good faith and fair dealing".

> "Delaware and New York treat the duty of good faith and fair dealing similarly: neither state will normally enforce terms that contradict the contractual language. "We will only imply contract terms when the party asserting the implied covenant proves that the other party has acted arbitrarily or unreasonably,... When conducting this analysis, we must assess the parties' reasonable expectations at the time of contracting and not rewrite the contract to appease a party who later wishes to rewrite a contract he now believes to have been a bad deal" (Nemec v Shrader, 991 A2d 1120, 1126 [Del 2010] [footnotes and quotation marks omitted]). "The implied covenant cannot contravene the parties' express agreement and cannot be used to forge a new agreement beyond the scope of the written contract."
>
> *Cohen PDC, LLC v Cheslock-Bakker Opportunity Fund, LP,* 2010 N.Y. Misc. LEXIS 5382, 31-32 (N.Y. Misc. 2010).

This proceeding by Univest is not meant to redress a wrong or to assure equity. It is an attempt to obtain a right not negotiated for under the Operating Agreement. The Operating Agreement as an integrated whole, cannot be parsed.

When negotiating the Operating Agreement, both parties had different priorities. BDC wanted to assure that it could operate parking on the property through an affiliated entity pending development of the property. In order to achieve that Buffalo Development Corporation was named the Manager and a lease was negotiated with Skydeck Corporation and consented to by Univest (Exhibit 1 (Exhibit E, page 8)). The lease had a right of termination to assure that the property would be available for development when the time came.

Univest I Corp. wanted to assure that its affiliated corporation, Uniland Construction Company, would have the opportunity to construct the development on the property (Exhibit 1 (Exhibit E, page 12)).

Both entities received the benefit of their investment by the terms of the Operating Agreement. Univest I Corp.'s affiliated entity was granted an exclusive right to construct the development and Buffalo Development Corporation affiliated entity was granted a lease pending development of the property. Univest I Corp. is now seeking to remove Skydeck Corporation so that it can bring in a new operator of the parking lot without a development pending. This was not contemplated by the members. Certainly as a matter of Summary Judgment in a petition setting, such a finding cannot be made.

A. The Court of Appeals Has Not Determined that Common Law Rights Trump Contracted For Limitations on Derivative Claims

The Court of Appeals was very clear that derivative rights are meant to provide an avenue for redress of an equitable nature. In the face of specifically contracted for limitations as present here such basis does not exist. Even in *Tzolis,* the Court affirmatively recognized limitations on the right to commence derivative actions:

> "What limitations on the right of LLC members to sue derivatively may exist is a question not before us today. We do not, however, hold or suggest that there are none."
>
> *Tzolis v. Wolff*, 10 N.Y.3d 100, 108-109 (N.Y. 2008).

CONCLUSION

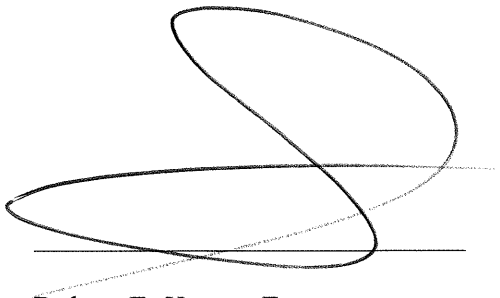
The parties are two sophisticated businesses that negotiated an Operating Agreement providing specific and enumerated consideration to each. It is a contract to be enforced as such. The Operating Agreement limited the ability to commence litigation to circumstances where a majority of the members agreed. Nothing in *Tzolis v. Wolff* prohibits such a limitation. In fact, the Court of Appeals left open just that possibility.

This possibility of limitation on the common law right specifically recognized by the Court of Appeals combined with a strong preference of New York Courts to allow, and in fact

encourage parties to define their relative rights and obligations through a written agreement argues strongly for this Court to uphold the limitation on litigation agreed to by the members. Especially here where the essence of the dispute is not based in fraud or a breach of fiduciary duty, but rather a business disagreement.

For all the reasons mentioned herein, it is respectfully submitted that permission be granted to reargue the Motion to Dismiss. Following argument, an order should enter dismissing the Petition in its entirety together with such other and further relief as the Court deems just and proper. Alternatively, the Court should amend the previous Order to provide that Skydeck Corporation will be dispossessed 30 days after a new tenant is secured.

Dated: Buffalo, New York
December 30, 2014



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