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

STEVE PAPPAS and CONSTANTINE IFANTOPOULOS, individually, and derivatively on behalf of VRAHOS LLC,	Index No.: 601115 / 09
Plaintiffs,	**MEMORANDUM OF LAW**
– against –	
STEVE TZOLIS and VRAHOS LLC,	
Defendants.	

Defendant Steve Tzolis respectfully submits this memorandum of law in support of his motion pursuant to CPLR 3211(a)(1) and (7), to dismiss the Verified Complaint brought by the plaintiffs, Steve Pappas and Constantine Ifantopoulos.

Issue

Under Delaware law, a limited liability company is a creature of contract. The members' agreements determine the existence and scope of fiduciary duties to one another or the company. Vrahos LLC's operating agreement permits a member to pursue his own, individual business interests "of any nature whatsoever" and "without obligations of any kind" to the LLC or other members. Does this unambiguous language forsake any duty to disclose by Tzolis before buying out his co-members?

Preliminary Statement

The parties formed Vrahos LLC as a single-purpose entity with a distinct and limited ability to turn a profit. Its purpose was to acquire a 49-year, triple-net, master lease on property located on Charlton Street, and then to promptly sublet (*i.e.*, effectively assign) the entire leasehold to Steve Tzolis for $4.00 per square foot more than the master lease. Sublease in-hand, Tzolis had the entire leasehold and was free to develop the property at his own risk, and to reap

the rewards or bear any losses himself. Vrahos LLC's assets consisted of its right to collect the $4.00 spread (*i.e.*, the rental payments under the sublease exceeding the company's obligations under the master lease) from Tzolis for the term of the lease.

Not surprisingly, in light of this arrangement, it was Tzolis who paid the security deposit, guaranteed all rental payments required under the master lease, and paid all formation expenses, real estate taxes, insurance and other operating and capital costs of the company. The other members (Pappas and Ifantopoulos), through their membership interests (40% and 20%, respectively) in Vrahos LLC, were merely the beneficiaries of the $4.00-per-square-foot spread between the master lease and the sublease, amounting to $20,000 per month.

Their membership interests yielded a swift and meaningful reward. Just one year after they formed Vrahos LLC—and having invested not a single penny—Pappas and Ifantopoluos agreed to buyouts from Tzolis totaling $1.5 million ($1 million for Pappas and $500,000 for Ifantopoulos, based on their respective membership interests).

Plaintiffs are now seeking a 60% share of the sales price Tzolis received for assigning the leasehold interest (in effect, his interest) to a developer, nonparty Extell. They allege several tort claims from the supposed fact (assumed true only for purposes of this motion) that Tzolis knew about and failed to disclose Extell's interest in acquiring the lease before he bought them out. The documentary evidence, in conjunction with Delaware law, establishes that Tzolis owed no duty to disclose, or any fiduciary duties, to them or the company.

Argument

I. Standard on this Motion to Dismiss

On a motion to dismiss pursuant to C.P.L.R. § 3211(a)(7), the court must accept the facts alleged in the complaint as true, and determine whether those facts fit into a cognizable legal theory. *Leon v. Martinez*, 84 N.Y.2d 83, 87-88, 638 N.E.2d 511, 513, 614 N.Y.S.2d 972, 974 (1994). The Court must afford the pleadings a "liberal construction" and give the plaintiffs the benefit of every possible inference. *Goshen v. Mutual Life Ins. Co.*, 98 N.Y.2d 314, 326, 774 N.E.2d 1190, 746 N.Y.S.2d 858 (2002). On a motion under CPLR §3211(a)(1), the documentary evidence that forms the basis of the defense must be such that it resolves all factual issues as a matter of law, and conclusively disposes of the plaintiff's claim. *Id.*

"The interpretation of an unambiguous contract is a question of law for the court, and the provisions of a contract addressing the rights of the parties will prevail over the allegations of the complaint." *Taussig v. Clipper Group, L.P.*, 13 A.D.3d 166, 167, 787 N.Y.S.2d 10 (1st Dep't 2004).

II. The Documentary Evidence Establishes that Tzolis Owed No Fiduciary Duties to the LLC or its Members.

A. Delaware Law Governs.

Vrahos LLC is a limited liability company that was formed in the State of Delaware. *See* Affirmation of Eric Weinstein dated June 10, 2009 ("Aff."), Ex. B (Certificate of Formation); *see also* Verified Complaint ¶ 5 ("Vrahos LLC . . . was duly formed, in January 2006, under the laws of Delaware").

New York law provides that Delaware law governs a dispute concerning internal affairs of a Delaware limited liability company. Section 801(a) of the New York Limited Liability Company Law is clear: "the laws of the jurisdiction under which a foreign limited liability

company is formed govern its organization and internal affairs and the liability of its members and managers . . ."; *see also Trump v. Cheng*, 9 Misc. 3d 1120A, 862 N.Y.S.2d 812 (New York Sup. 2005) (applying Delaware law to a fiduciary-duty dispute between partners of a Delaware limited partnership over the sale of real property in New York to, ironically, the same nonparty-buyer, Extell, as here).[1] Accordingly, Delaware law applies.

B. Delaware Law Looks to the Members' Agreements to Determine the Existence and Scope of Fiduciary Duties.

Under Delaware law, a limited liability company is purely a creature of contract. *See, e.g., Fisk Ventures, LLC v. Segal*, 2008 Del. Ch. LEXIS 158, at *1 (Del. Ch., May 7, 2008) ("Contractual language defines the scope, structure, and personality of limited liability companies.").

The members' agreements determine the existence and scope of any fiduciary duties, as set forth in section 18-1101 of the Delaware Limited Liability Company Act. It states, in pertinent part, the following:

> (a) The rule that statutes in derogation of common law are to be strictly construed shall have no application to this chapter.
>
> (b) It 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.
>
> (c) To the extent that, at law or in equity, a member or manager . . . has duties (including fiduciary duties) to a limited liability company or to another member or manager . . ., the member or manager's . . . duties may be expanded or restricted or eliminated by provision in the limited liability company agreement . . .

[1] Delaware law applies notwithstanding the choice-of-law provision in the operating agreement. *See* Aff. Ex. D at ¶ 15 ("This Agreement shall be governed and construed under the substantive laws of the State of New York); *BBS Norwalk One, Inc. v. Raccolta, Inc.*, 60 F. Supp. 2d 123, 129 (S.D.N.Y. 1999) (holding that Delaware law applies to a claim for aiding and abetting breach of fiduciary duty owed to a Delaware corporation despite New York choice-of-law provision).

The term "limited liability company agreement" is defined as "any agreement . . . written, oral or implied, of the member or members as to the affairs of [the company] and conduct of its business." Del. Code Ann. tit. 18 § 101 (2009).

Delaware courts applying the statute confirm that members of a limited liability company have wide latitude to order their relationships. They are free to reduce or even eliminate the traditional, common-law fiduciary duties. *Bay Center Apartment Owner, LLC v. Emery Bay PKI, LLC,* 2009 Del. Ch. LEXIS 54, at *25 (Del. Ch., Aug. 20, 2009); *see also Fiske, supra*, at *28-30 (finding no fiduciary duties exist among members of a Delaware limited liability company).

The members' agreements should be construed under contract principles, with no overlay of fiduciary duties superimposed upon it. *See Sonet v. Timber Co.,* 722 A.2d 319, 322 (Del. Ch. 1998) (noting that contract principles "preempt" fiduciary principles.); *see also Continental Ins. Co. v. Rutledge & Co.,* 750 A.2d 1219, 1236 (Del. Ch. 2000) (applying "principles of contract construction that court have traditionally employed in construing written contracts").

C. The Parties' Agreements Forsake Fiduciary Duties.

Vrahos LLC's operating agreement was executed on January 13, 2006 by the members, Steve Tzolis, Steve Pappas and Constantine Ifantopoulos. *See* Aff. Ex. C. It articulates the company's business and purpose:

- Vrahos would enter into a triple-net, 49-year master lease on real property located at 68-74 Charlton Street, with Tzolis providing to the landlord a security deposit exceeding $1.1 million and a personal guaranty.

- Tzolis or a company he designated would have the right to sublet the property on the same terms and conditions as the master lease, in exchange for which Tzolis would pay Vrahos a $4-per-square-foot premium ($20,000 per month) with a personal guaranty.

- Tzolis would pay (or promptly reimburse) the initial capital contributions of Pappas and Ifantopoulos, effectively paying all of the company's formation expenses, real estate taxes, insurance and other operating and capital costs.

Under the operating agreement, Vrahos LLC's rights were solely to collect the spread of $20,000 per month from Tzolis for the term of the lease. One only need to review section 4(d), which gives Tzolis (or his company) the right to sublet the entire leasehold "on the same terms and conditions as the Lease," except for the extra payment to Vrahos LLC of $4 per square foot. *See Bokhara Realty Corp. v. Barton's Bonbonniere, Inc.*, 19 Misc.2d 1086, 189 N.Y.S.2d 255 (N.Y. App. Term 1959) (sublease under the identical term as the master lease without retaining reversionary interest constituted assignment of the master lease). The members contemplated that the sublease was, in effect, an assignment of the leasehold to Tzolis.

Pappas and Ifantopoulos were not obliged to contribute a single penny to the formation or operation of Vrahos LLC. Tzolis paid the security deposit and gave his personal guaranty under the master lease. And Tzolis was obliged to pay all of Vrahos LLC's operating and capital costs. This was contemplated in section 4(d)(8) of the operating agreement, which provides "Tzolis shall pay [or reimburse Pappas and Ifantopoulos] . . . all expenses relating to the formation of the LLC and the execution and delivery of the Lease, including . . . all brokerage, legal and other expenses, and all real estate taxes, insurance and other operating and capital costs of the LLC relating to the Lease or the Property."

Thus Vrahos LLC was, for practical purposes, a vehicle for assigning all rights under the master lease to Tzolis for $20,000 per month, 60% of which would then be paid to Pappas and Ifantopoulos as members. Supporting this, section 4(d)(4) of the operating agreement gives Tzolis the right to pay directly to the landlord all rents payable under the master lease. Hence,

the members contemplated that the company's sole function would be to collect from Tzolis the $20,000 monthly premium (*i.e.*, $4.00 per square foot) and distribute it to the members.

Given the company's extremely limited business purpose, and the fact that all decisions were to be by unanimous consent, the company allowed its members wide latitude to pursue their own individual business interests and limited their liability to each other and to the company. Paragraph 11 of the operating agreement provides, "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." *See* Aff. Ex. C (emphasis supplied).

Plaintiffs allege that Tzolis had a duty to disclose.[2] Yet, paragraph 11 of the operating agreement unambiguously provides that a member owes no fiduciary obligations to the company or other members and may engage in business activities of any nature. Tzolis was free to engage in any lawful business activities, owing no duty to disclose or other fiduciary duties to the Vrahos LLC or to Pappas or Ifantopoulos. Moreover, paragraph 12 of the operating agreement provides:

> 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 the Agreement, other than acts of fraud, bad faith or willful misconduct

Under paragraph 12, a member is not liable to the company or other members for any act performed "pursuant to the authority granted" under the operating agreement.

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[2] In pre-litigation correspondence, they cited *Blue Chip Emerald LLC v. Allied Partners Inc.*, 299 A.D.2d 278, 750 N.Y.S.2d 291 (1st Dep't 2002), voiding a disclaimer of fiduciary duties in a buyout of membership interests in a Delaware limited liability company. That case is distinguishable because it was decided under New York law and the court was not asked to address, let alone interpret, the members' operating agreement.

The assignments were authorized under the operating agreement. Paragraph 14.1 permits a member's purchase of another member's interest, provided that certain specified procedures therein are complied with. It requires that the selling member give an Offer Notice to the other members to sell "at a price and on other reasonable terms" set forth in such notice, and offer his interest at a price no less favorable than any existing offer to a third party. When Pappas and Ifantoulos agreed to sell their interests to Tzolis, the members agreed to waive the requirements. *See* Aff. Exs. E, F, section 4. Furthermore, paragraph 10.1 of the operating agreement grants the managers, when acting unanimously, "sole and unrestricted discretion" with respect to the operations and activities of the company. All three members, acting in their capacity of managers on behalf of Vrahos LLC, consented to waive the requirements related to the sale of their membership interests.

The formalities having been either followed or duly waived, Tzolis' purchase of the other members' interests was made pursuant to the authority granted under the operating agreement. The operating agreement contains no language which may be interpreted to impose a duty to disclose or other fiduciary duties on a selling or purchasing member. Courts are not free to alter the terms of a contract to impose such duties.

As for the phrase in paragraph 12 of the operating agreement "other than fraud, bad faith or willful tortuous misconduct," it creates no particular code of conduct for the member or managers because it contains no guidance as to how or when it applies. *See Fisk, supra,* 2008 Del.Ch.LEXIS 158 at *32-34 (declining the plaintiff's "invitation to turn an expressly exculpatory provision into an all encompassing and seemingly boundless standard of conduct").

Finally, further supporting that Tzolis owed no fiduciary duties is the Certificate signed by the members on January 18, 2007. It states in pertinent part:

> [E]ach of the undersigned sellers agrees that Steve Tzolis has no fiduciary duty to the undersigned sellers in connection with such assignments. . . . Steve Tzolis agrees that each of the undersigned sellers has no fiduciary duty to Steve Tzolis in connection with such assignments.

See Aff. Ex. G (Certificate); *see also* Aff. Exs. E, F (Assignments from Pappas to Tzolis and from Ifantopouos to Tzolis).

III. The Assignments Are Neither Voidable Nor Void.

Plaintiffs allege that the assignments are voidable (subject to rescission) because Tzolis breached a duty to disclose. As discussed *supra*, Tzolis had no such duty under Delaware law. Plaintiffs also allege that the assignments are void by virtue of the non-occurrence of the original "Effective Date" by February 5, 2007, which the parties amended by extending the deadline to March 12, 2007. *See* Verified Complaint, ¶ 20. This argument is also infirm.

A void contract, unless void as against the public policy, may be ratified by making a new one containing the same terms and conditions, or by ratifying the old one—the contract taking effect as of the date of the ratification. *See, e.g., Lawrence v. Morris*, 167 A.D. 186, 193, 152 N.Y.S. 777, 781 (1st Dep't 1915) (contract signed when incompetent and ratified after regaining competency).

Here, all three members and the company signed an Estoppel Agreement amending the effective date of the Assignment Agreements. *See* Verified Complaint, ¶ 20. Just after the amendment, Tzolis delivered the "Consent of Landlord and Release" to Pappas and released the purchase moneys from escrow to Pappas and Ifantopoulos. *See* Verified Complaint, ¶¶ 21-22. Accordingly, the contract which was allegedly void was ratified by the same parties and the

company. Tzolis completed the performance of his obligations under the Assignment Agreements. He is entitled to the benefit of such ratification.

IV. Tzolis Did Not Breach the Covenant of Good Faith and Fair Dealing.

Under Delaware law, every contract contains an implied covenant of good faith and fair dealing that requires a party in a contractual relationship to refrain from arbitrary or unreasonable conduct which has the effect of preventing the other party to the contract from receiving the fruits of the bargain. *Fisk Ventures, supra,* 2008 Del. Ch.LEXIS 158, at *37. The covenant cannot be invoked where the contract itself expressly covers the subject at issue. *Id.*, at *38.

Here, the operating agreement expressly eliminates a member's duty to disclose and other fiduciary duties. Moreover, in connection with the Assignments, the members certified in the Certificate that Tzolis owed no fiduciary duties to the other members and vice versa. In the presence of such an express exclusion of fiduciary duties, the covenant cannot be invoked to argue the existence of fiduciary duties.

Conclusion

It is the court's duty to interpret the limited liability company agreements under Delaware law. Here, the agreements may be interpreted just one way: the members owed no fiduciary duties to one another or to the company. Tzolis respectfully submits that the court grant this motion to dismiss the complaint in its entirety, with prejudice and without leave to re-plead.

Dated: New York, New York
June 10, 2008

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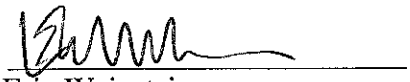
By: 

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