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

	:	**Index No. 601115/09**
STEVE PAPPAS and CONSTANTINE IFANTOPOULOS, Individually, and Derivatively on Behalf of VRAHOS LLC,	:	
Plaintiffs,	:	
-against-	:	
STEVE TZOLIS and VRAHOS LLC,	:	
Defendants.	:	

MEMORANDUM OF LAW IN OPPOSITION TO DEFENDANTS' MOTION TO DISMISS UNDER CPLR 3211(a)(1) AND 3211(a)(7)

Dated: **New York, New York**
July 23, 2009

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Preliminary Statement

This memorandum of law is submitted in opposition to the motion to dismiss made by defendants Steve Tzolis ("Tzolis") and Vrahos LLC ("Vrahos").

The statement of facts in the Preamble to the Defendants' Memorandum of Law dated June 10, 2009 (the "Tzolis Memorandum") is so distorted by falsehoods and other inaccuracies that it conveys a completely misleading impression of what actually happened. The actual facts are set forth in the Plaintiffs' complaint, as augmented by the accompanying affidavit of Plaintiff Steve Pappas (the "Pappas Affidavit").

Moreover, the legal analysis by Defendants is also materially misleading and incorrect, as discussed below.

THE FACTS

I. VRAHOS LLC (THE TENANT UNDER THE MASTER LEASE) WAS NOT FORMED FOR THE PURPOSE OF SUBLETTING TO TZOLIS

Although the Tzolis Memorandum asserts (at page 1) that Vrahos was formed in order to sublease/assign to Tzolis the 49-year lease owned by Vrahos, this is not true. Paragraphs 10, 12-14, and 16-17 of the Pappas Affidavit state that the three members of Vrahos (i.e., Messrs. Ifantopoulos, Pappas and Tzolis) had no mutual intention or agreement to enter into any sublease to Tzolis when Vrahos first acquired its 49-year lease. The documentary evidence confirms this. The final executed lease by 68 & 74 Charlton Street Company, LLC (the owner of 68-74 Charlton Street, N.Y., N.Y.) (the "Property") to Vrahos (the "Vrahos Lease") was dated as of **January 13, 2006**, and contained no provision regarding any sublease to Tzolis. The actual sublease by Vrahos to 108 Realty of N.Y. Corp. (the Tzolis designee, called the "Tzolis Subtenant"; and such sublease being called the "Tzolis Sublease") was dated as of **June 16, 2006** (more than 6 months after Vrahos first acquired the Vrahos Lease), but was not finalized and signed until on or after July 14, 2006, the date that the last draft of the Tzolis Sublease was prepared. The initial draft of the operating agreement of Vrahos (the "Vrahos Operating Agreement"), which was circulated on or before the date of the signing of the Vrahos Lease, had no provision for any sublease to Tzolis. The final version of the Vrahos Operating Agreement, which provided in Section 4 for a sublease to Tzolis, was dated as of January 13, 2006, but the Vrahos Operating Agreement was not actually finalized and signed until a date on or after March 14, 2006 (the date of the last draft of the Vrahos Operating Agreement), and was therefore not signed or delivered until such date or thereafter. Therefore, the Tzolis Memorandum is mistaken

when it falsely asserts (at page 5) that the Vrahos Operating Agreement was executed on January 13, 2006.

Further, while pages 5-6 of the Tzolis Memorandum assert repeatedly that Section 4 of the Vrahos Operating Agreement provided for a sublease to Tzolis, the truth is that Tzolis declined to rely on the "sublease" provisions in Section 4 of the Vrahos Operating Agreement, and insisted on a separate new sublease, in part because Tzolis was unable to obtain the release of Steve Pappas from his guaranty of the Vrahos Lease. Pursuant to Sec. 4(5) of the Vrahos Operating Agreement, such release was a necessary precondition to the effectiveness of the "sublease" provisions of the Vrahos Operating Agreement. Moreover, Section 4(7) of the Vrahos Operating Agreement also required that Vrahos LLC and the Tzolis designee enter into a separate sublease on or before March 31, 2006, which never occurred.

Therefore, the "sublease" provisions of Section 4 of the Vrahos Operating Agreement never became effective, and were basically a "dead letter" and not a basis for any issues in this lawsuit. Accordingly, a number of the factual recitals (referring to the "sublease" provisions of Section 4) in, and large portions of, the Tzolis Memorandum are wholly inaccurate, such as at pages 5-7.

In summary, the Tzolis Sublease was not reflected in any written documents executed as of the date of the original January 13, 2006 sublease. Moreover, a sublease to Tzolis was not the original intention of the 3 members of Vrahos (and was not even discussed at the time the original Vrahos Lease was negotiated and signed). The Tzolis Sublease arose as a result of the natural evolution of Vrahos over time thereafter, following requests by Tzolis for (1) originally, only a limited right to take possession for a temporary period of a few months, while he was

trying to decide what to do with the property, and (2) only later, the long-term right to develop and use the space leased to Vrahos.

II. TZOLIS SUBLEASE WAS NOT A DE FACTO ASSIGNMENT OF ALL RIGHTS

Although the Tzolis Memorandum asserts (at page 1) that the Tzolis Sublease was an "effective" assignment of the Vrahos Lease, this Tzolis Sublease was not the same as an assignment of the Vrahos Lease to the Tzolis Subtenant. There are many significant differences, set forth below, which also rebut the claim, by the Tzolis Memorandum (at page 5) that the sublease to Tzolis was on "the same terms and conditions" as the Vrahos Lease.

1. Commencement of term of Tzolis Sublease was not co-terminous with commencement of term of Vrahos Lease. The Vrahos Lease commenced on January 13, 2006 (the date of the Vrahos Lease), pursuant to Section 1.1 ("Commencement Date") of the Vrahos Lease. However, according to Section 2.2 of the Tzolis Sublease, the term of the Tzolis Sublease did not commence until the later of (1) the 30th day after the owner of the real estate had received a counterpart of the Tzolis Sublease, and (2) the date that such owner had consented to the Tzolis Sublease and had released Steve Pappas from his guaranty of the Vrahos Lease. See also Section 12 of the Tzolis Sublease. This release never occurred. However, Tzolis sent a July 10, 2006 fax to Steve Pappas with an unsecured indemnity by Tzolis against any claims under the guaranty made by Steve Pappas, and thereafter the Tzolis Subtenant continued in occupancy of the Property pursuant to the Tzolis Sublease.

2. Expiration of term of Tzolis Sublease was not co-terminous with the date of the expiration of the Vrahos LLC master lease. The Tzolis Memorandum asserts (at page 6) that the Tzolis Sublease was an assignment because the expiration date of the Tzolis Sublease and the

Vrahos Lease were the same, citing *Bokhara*. However, following standard practice in the real estate industry, the term of the Tzolis Sublease was one day less than the term of the Vrahos Lease. Compare Sec. 1.9 ("Expiration Date") of the Tzolis Sublease with Section 1.1 ("Expiration Date") and Article 32 ("Renewal Options") of the Vrahos Lease. Further, the term of the Tzolis Sublease could also expire on any of the following events that would not affect (or cause) the expiration of the Vrahos Lease: (1) the failure to pay rent, (2) the failure of Tzolis to provide the security deposits or guaranties required by the Tzolis Sublease, (3) the failure by the Tzolis Subtenant to perform other obligations under the Tzolis Sublease, and (4) the failure of the Tzolis Subtenant to cure any obligations under the Vrahos Lease which are then cured by Vrahos.

3. Right of Tzolis Subtenant not to Renew & to "Put" Premises Back to Vrahos. Pursuant to Section 1.9 and Exhibit D(12) (see the second set of numbered items in Exhibit D after "Notwithstanding . . .") of the Tzolis Sublease, the Tzolis Subtenant had the right to elect not to extend the term after June 29, 2036, in which case Vrahos LLC would have had the right to collect all rents from the Property for 18 years thereafter, pursuant to the Vrahos Lease, free of the Tzolis Sublease, and thus receive more or less than the "net" $4 per square foot amount provided in Sections 1.10 and 3.1 of the Tzolis Sublease.

4. Other Differences between Vrahos Lease and Tzolis Sublease. *No Landlord Representations:* According to Section 5.3 of the Tzolis Sublease, Vrahos LLC was deemed not to make any of the representations by the owner of the real estate under the Vrahos Lease. See also Sections 4.2 and 9.3 and Exhibit D, § 8 (see the second set of numbered items in Exhibit D after "Notwithstanding . . ."), of the Tzolis Sublease. *No Services & Utilities.* According to Section 5.3.1 of the Tzolis Sublease, Vrahos LLC was not obligated to provide any of the

services and utilities provided by the owner of the real estate under the Vrahos Lease. See also Section 9.3 of the Tzolis Sublease. *No Repairs:* According to Section 5.3.2 of the Tzolis Sublease, Vrahos LLC was not obligated to provide any of the repairs or restorations provided by the owner of the real estate under the Vrahos Lease. See also Section 4.2 of the Tzolis Sublease. *No Burden of Legal Compliance:* According to Section 5.3.3 of the Tzolis Sublease, Vrahos LLC was not obligated to assume any of the burden of legal compliance that was assumed by the owner of the real estate under the Vrahos Lease. *No Responsibility for Common Areas:* According to Section 5.3.4 of the Tzolis Sublease, Vrahos LLC was not obligated to assume any of the operational duties of the owner of the real estate under the Vrahos Lease. See Ex. D, § 7 (see the initial set of numbered items in Exhibit D before "Notwithstanding . . .") of the Tzolis Sublease. *Shorter Cure Periods:* The cure periods for the Tzolis Subtenant under Section 5.6 of the Tzolis Sublease were generally 5 business days shorter than the cure periods under the Vrahos Lease. *Double Insurance & Indemnities:* The Tzolis Subtenant was required to provide insurance and indemnification not only for Vrahos LLC (as Sublandlord) but also the owner of the real estate (as Overlandlord). See Sections 6.1 and 6.2 of the Tzolis Sublease. The Tzolis Subtenant also provided additional indemnities not provided in the Vrahos Lease. See Section 6.3 of the Tzolis Sublease. However, Vrahos was not obligated to provide insurance. Ex. D, § 2 (see the first set of numbered items in Exhibit D before "Notwithstanding . . .").

III. TZOLIS WAS NOT THE SOLE OWNER OF THE VRAHOS LEASE, BUT MERELY A CO-MEMBER/MANAGER OF VRAHOS

Although the Tzolis Memorandum (at pages 1-2) asserts that Tzolis was the real owner of the Vrahos Lease, and that Plaintiffs Pappas and Ifantopoulos were the "beneficiaries" of only their 60% share of a $4 per square foot per year payment stream payable under the Tzolis

Sublease, however, this assertion is false. Vrahos was the tenant under the Vrahos Lease, and each of Messrs. Ifantopoulos, Pappas and Tzolis was a member and manager of Vrahos. From (1) January 13, 2006, the commencement date of the Vrahos Lease, until (2) after March 14, 2006, the date on which the Vrahos Operating Agreement was finalized and sent out for review and signature, the members of Vrahos (i.e., Ifantopoulos, Pappas and Tzolis) had the same rights and obligations against each other, and were not governed by the Vrahos Operating Agreement. Thereafter, once the Vrahos Operating Agreement was signed, the members were subject to it, but generally were on a par thereunder (although Gus Ifantopoulos had a 20% interest while Messrs. Pappas and Tzolis each had 40% interests). See, *e.g.*, Section 18.1(b) of the Vrahos Operating Agreement (requiring the consent of members holding at least 66% of the percentage interests in the case of a dissolution or termination of Vrahos). The unanimous consent of Messrs. Ifantopoulos, Pappas and Tzolis, as the three co-managers, was generally required to any binding action by the managers of Vrahos. See, *e.g.*, Sections 10.1 and 10.6 of the Vrahos Operating Agreement. Moreover, Messrs. Ifantopoulos, Pappas and Tzolis each had capital accounts in Vrahos (See Sec. 7 of the Vrahos Operating Agreement). Further, all members of Vrahos were entitled to share in "Profits" and "Losses" pursuant to Section 8.2 and 8.3 of the Vrahos Operating Agreement. All members of Vrahos were entitled to distributions pursuant to Article 9 of the Vrahos Operating Agreement.

According to the Vrahos Operating Agreement, Pappas and Ifantopoulos, along with Tzolis, had the following significant obligations: (1) to make initial capital contributions,[1] and

[1] The initial capital contributions of Messrs. Ifantopoulos and Pappas were required to be reimbursed by Tzolis pursuant to Section 4(8) of the Vrahos Operating Agreement if Tzolis exercised his right under Section 4 of the Vrahos Operating Agreement to enter into a sublease, but Tzolis failed to exercise his right to enter into a sublease pursuant to Section 4 of the Vrahos Operating Agreement. All or part of the capital contributions of Messrs. Ifantopoulos and Pappas were eventually reimbursed to them out of the Vrahos LLC operating account after the Tzolis Sublease was eventually finalized. See Paragraphs 17-20 of the Pappas Affidavit.

(2) to advance their respective Percentage Interest of Member Loans or make capital contributions in lieu thereof (Sec. 5 of Vrahos Operating Agreement). Further, all members of Vrahos had significant personal obligations, that arose by operation of law, by virtue of the ownership by Vrahos of its leasehold interest in the Property, and its operations, such as under the environmental laws.

Therefore, it is completely false for the Tzolis Memorandum to assert at pages 1-2 that Vrahos was formed in order to sublease the Property to Tzolis, and that 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." Based on the Vrahos Operating Agreement, Messrs. Ifantopoulos, Pappas and Tzolis were actually a "band of brothers."

Further, as noted above, the Tzolis Subtenant had the option not to pay the $4 per square foot additional rent after June 29, 2036. Moreover, the Tzolis Subtenant was merely a corporation, and the Tzolis Subtenant could elect to refuse to pay any rent (although Tzolis technically promised to guaranty such rent payments). In fact, from the outset of the rent commencement date under the Tzolis Sublease, the Tzolis Subtenant refused to pay any part of the $20,000 per month it promised to pay Vrahos, and as a result Plaintiffs received no payment from the Tzolis Subtenant or Tzolis of their shares of the $4 per square foot additional rent at all. Tzolis, with ultimate chutzpah, argues at pages 1-2 and 5 in the Tzolis Memorandum that Pappas and Ifantopoulos had surrendered their rights in the Property for the promise of a $2.40 per-square-foot rental payment stream, which the Tzolis Subtenant never actually paid.

Although the Tzolis Memorandum (at pages 2 and 5) mentions only Tzolis as the guarantor of the obligations of Vrahos under the Vrahos Lease, this assertion is misleading.

Steve Pappas also guaranteed the obligations under the Vrahos Lease, effective from inception (in January, 2006), and was not released from this obligation until February, 2007.

The Tzolis Memorandum (at pages 2 and 6) states that Gus Ifantopoulos and Steve Pappas did not invest a penny, but this is false. Steve Pappas made his promised capital contribution of $50,000 to Vrahos, on January 23, 2006 and Gus Ifantopoulos made payment of $15,000, of his promised $25,000 capital contribution, on February 11, 2006. However, when Tzolis in September, 2006 made it clear that he wanted to buy-out Messrs. Ifantopoulos and Pappas, then part or all of their capital contributions were returned to them.

While Tzolis did fund more than the other two Vrahos members, this was his role. Pappas and Ifantopoulos brought the deal to Vrahos LLC for the good of all of the members. Tzolis likewise put up capital not just to further his own membership interest but equally to further the membership interests of the two other members (i.e., Vrahos members). The mere fact that one member provides most or all of the capital does not automatically convert the express contractual rights of co-members in a limited liability company (an "LLC") to a mere nominee arrangement in favor of the member providing the capital (a "Money Rules" principle). A "Money Rules" principle is not the law, and the application of such a "Money Rules" principle would wreak havoc on commercial relationships. Fortunately, as discussed in more detail below, contractual rights (as represented by the Vrahos Operating Agreement among the Vrahos members) are respected by the courts and the legislatures. A "Money Rules" principle would place an impossible burden on judges to cast aside the express contracts of the parties, and then sift through circumstantial evidence and guess whether a different business relationship should be imposed by the court on the parties.

THE LAW

I.

TZOLIS BREACHED HIS FIDUCIARYDUTIES BY SECRETLY EXPLOITING A PROFITABLE OPPORTUNITY OF VRAHOS; AND ANY WAIVER OF SUCH BREACH IS VOID SINCE TZOLIS FAILED TO MAKE FULL DISCLOSURE

What legal standards should be applied by a New York State court when one member of a Delaware LLC (1) discovers an opportunity to sell the LLC's property for a substantial profit, (2) purchases his co-members' interests without disclosing such opportunity, and (3) then sells such property for a substantial profit?

In *Blue Chip Emerald LLC v. Allied Partners Inc.*, 299 A.D.2d 278, 750 N.Y.S.2d 291 (App. Div., 1st Dept. 2002), Blue Chip, a 50% member of a Delaware LLC owning 1 East 57th Street in Manhattan, sold its 50% interest to the other 50% "Hadar" member based on an **$80 million** valuation of the property owned by the LLC.

The Blue Chip member signed an agreement (called the "Buy-Out Agreement") (1) acknowledging that the Hadar member and its principals had contacted 16 third parties (including LVMH) regarding a possible sale of the property, and (2) disclaiming all interest in any profit realized by the Hadar member and its principals on a future sale of the property to any of the disclosed 16 third parties, and (3) also disclaiming "any claim for fraud, breach of loyalty or fiduciary duty" arising out of the participation of the Hadar member or its principals in the Delaware LLC.

The Hadar Member and its principals subsequently entered into a contract to sell the property to LVMH for **$200 million**.

The New York State Appellate Division (First Department), by a 5-0 vote, ruled that, since the Hadar member and its principals were fiduciaries of the Blue Chip member until the

closing of the buy-out, therefore the Blue Chip member was entitled to sue the Hadar member and its principals for fraud and breach of fiduciary duty. The court said,

> [I]t is well established that, when a fiduciary, in furtherance of its individual interests, deals with the beneficiary of the duty in a matter relating to the fiduciary relationship, the fiduciary is strictly obligated to make "full disclosure" of all material facts . . . . Stated otherwise, the fiduciary is obligated in negotiating such a transaction "to disclose any information that could reasonably bear on [the beneficiary's] consideration of [the fiduciary's] offer" . . . . Absent such full disclosure, the transaction is voidable.
>
> It follows from the foregoing principles that, in negotiating the Buy-Out Agreement, the Hadar Defendants had no right to keep to themselves or misrepresent material facts concerning their efforts to sell or lease the [LLC]'s Property, such as, for example, the prices prospective purchasers were offering to pay. If the Hadar Defendants kept silent about such matters, or misrepresented them, as alleged in the complaint, the contractual disclaimers . . . would be voidable as the fruit of the fiduciary's breach of its obligation to make full disclosure. Defendants have not brought to our attention any authority, from either New York or Delaware (the state under whose law the [LLC] was organized), that would give effect to a waiver of a fiduciary's**295 duty of full disclosure that the fiduciary obtained by means of its breach of that very duty, even where the party that gave the waiver was, like [the Blue Chip member], commercially sophisticated and advised by its own counsel. Thus, even if the disclaimers of the Buy-Out Agreement would have negated any allegation of reliance on the Hadar Defendants by a party to whom they owed no fiduciary duty . . ., such disclaimers must be deemed ineffective, . . . as against [the Blue Chip member], to whom the Hadar Defendants did owe such a duty. Similarly ineffective to bar this action . . . is the general release [the Blue Chip member] executed in favor of the Hadar Defendants and their attorneys, among others, pursuant to the Buy-Out Agreement. In sum, a fiduciary cannot by contract relieve itself of the fiduciary obligation of full disclosure by withholding the very information the beneficiary needs in order to make a reasoned judgment whether to agree to the proposed contract.
>
> In declining to give effect to [the Blue Chip member]'s statements in the Buy-Out Agreement that it had been afforded an opportunity to conduct its own "due diligence" investigation into the disclosed potential purchasers of the Property, and that it was "satisfied" with the information it had obtained, we note that it cannot be said as a matter of law that [the Blue Chip member] had at its disposal ready and efficient means for obtaining or verifying the relevant information on its own . . . . 299 A.D.2d at 279-280, 750 N.Y.S.2d at 294-295.

Unlike the situation in *Blue Chip*, which involved **very substantial, but incomplete**, disclosures to the member being bought-out, however, in the case of the purchase by Tzolis of the interests of Messrs. Ifantopoulos and Pappas in Vrahos, there was basically **no** disclosure to

them of the opportunity to sell the Vrahos Lease to the Extell affiliate. Since Messrs. Ifantopoulos and Pappas did not even know the identity of the purchaser (unlike the seller in *Blue Chip*, which actually knew the name of the ultimate purchaser of the property), there was no one that they could contact in order to attempt to perform their own due diligence regarding the sale of the Vrahos Lease.

Essentially, Tzolis was obligated to lay all of his cards on the table, and make a candid, honest, good faith, disclosure of all of his discussions with Extell at the time that he bought their interests. However, he failed to do that.

The basic *Blue Chip* facts are the same as the basic facts in this case. Both cases involve a dispute between members of a Delaware LLC (299 A.D.2d at 278, 750 N.Y.S.2d at 293). Both cases involve a Delaware LLC that qualified to do business in New York. Both cases involve New York real property. And in both cases the parties reside or do business in New York City. The Tzolis Memorandum (at page 7, fn 2) attempts to distinguish *Blue Chip* on the ground that (1) it was decided under New York law, and (2) the court was not asked to address or interpret the operating agreement. However, the Appellate Division in *Blue Chip* did say that it had considered Delaware law. 750 N.Y.S.2d at 294-95. Moreover, the limited or irrelevant contractual provisions that Tzolis is relying on, to attempt to defeat his obligations to Plaintiffs Ifantopoulos and Pappas, involve alleged waivers of fiduciary duties, and yet much broader clear waivers were ruled in *Blue Chip* to be void because of the failure of the buying member in *Blue Chip* to make full disclosures to the selling member. Further, the court in *Blue Chip* did interpret the "Buy-Out Agreement," among the members of the applicable Delaware LLC, which amended and terminated the rights of the selling member under the LLC operating agreement,

and purported to provide for a general release and waiver of fiduciary obligations of the purchasing member. Therefore, *Blue Chip* is directly on point.

II.

NEW YORK LAW SHOULD BE APPLIED

There are good reasons for applying New York law to the breach by Tzolis of his fiduciary duties to Messrs. Ifantopoulos and Pappas.

Members of Vrahos Agreed to Apply N.Y. Substantive Law. First, Section 15 of the operating agreement for Vrahos LLC states:

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

The parties therefore agreed, in Section 15 of the Vrahos Operating Agreement, to apply New York substantive law. Indeed, the reference to "substantive law" is significant because this indicates the actual law that the parties wanted to apply, even if conflicts of laws principles might initially dictate a reference to Delaware law.

N.Y. Statute Validates N.Y. Choice of Law Provision. Second, the New York State legislature has made it clear that a New York choice of law clause in an agreement will be enforced even if the agreement does not have a reasonable relationship to New York State. Section 5-1401 of the New York State General Obligations Law states in part:

> § 5-1401. Choice of law. 1. The parties to any contract, agreement or undertaking, contingent or otherwise, in consideration of, or relating to any obligation arising out of a transaction covering in the aggregate not less than two hundred fifty thousand dollars, including a transaction otherwise covered by subsection one of section 1-105 of the uniform commercial code, may agree that the law of this state shall govern their rights and duties in whole or in part, whether or not such contract, agreement or undertaking bears a reasonable relation to this state. . . . .

In our case, it is clear that the parties have a reasonable relationship to New York State. In the absence of fraud or a violation of public policy, a contractual requirement for the application of New York law will be enforced. See Boss v. American Express Financial Advisors Inc., 15 A.D.3d 306, 307, 791 N.Y.S.2d 12, 14 (1st Dept. 2005), *aff'd* 6 N.Y.3d 242, 811 N.Y.S.2d 620, 844 N.E.2d 1142 (2006).

N.Y. as the Forum State May Apply N.Y. Law Since There is No Meaningful Conflict With Delaware Law. New York courts initially determine the scope of a choice of law provision under New York law, the law of the forum. *J.A.O. Acquisition Corp. v. Stavitsky*, 192 Misc. 2d 7, 11, 745 N.Y.S.2d 634, 638 (Sup. Ct., N.Y. Cty. 2001), *aff'd* 293 A.D.2d 323, 739 N.Y.S.2d 821 (1st Dept. 2002); *Winter-Wolff Int'l v. Alcan Packaging Food & Tobacco Inc.*, 499 F. Supp. 2d at 240. The New York court must first determine whether there is an actual conflict between New York law and the law of the state proposed by one of the parties to the case. *Matter of Allstate Ins. Co. (Stolarz)*, 81 N.Y.2d 219, 223, 597 N.Y.S.2d 904, 905, 613 N.E.2d 936, 937 (1993). If there is no meaningful conflict between the laws of the competing jurisdictions, then no choice of law analysis is necessary. *In re Rezulin Products Liability Litigation*, 390 F. Supp. 2d 319, 330 (S.D.N.Y. 2005). As described below, there is no meaningful conflict between New York and Delaware law regarding the fiduciary obligations of Tzolis.

New York Has the Greatest Interest in Regulating the Conduct of the Parties. If there is no applicable conflict of laws provision, then New York courts will apply the law of the jurisdiction having the "greatest interest" in regulating the conduct that is the subject of the litigation. *Winter-Wolff Int'l v. Alcan Packaging Food & Tobacco Inc.*, 499 F. Supp. 2d 233 (E.D.N.Y. 2007). "Under New York conflict of law principles, fraud claims are governed by the law of the place of injury-in this case New York, where plaintiffs are located." *J.A.O.*

Acquisition Corp., 192 Misc. 2d at 11, 745 N.Y.S.2d at 639. See also *Matter of Allstate Ins. Co. (Stolarz)*, 81 N.Y.2d at 225, 597 N.Y.S.2d at 907-908, 613 N.E.2d at 938-939 (even when applying modern "interest analysis," the place where the tort occurred "has an overriding interest in regulating conduct within its borders"); *In re Rezulin Products Liability Litigation*, 390 F. Supp. 2d at 335. Courts generally are protective of tort victims, and will therefore tend to apply the law of the state where the tort occurred, and will narrowly construe choice of law provisions that might require the application of the law of another state that has no real connection with the parties and the acts complained of. See *Matter of Allstate Ins. Co. (Stolarz)*, 81 N.Y.2d at 226, 597 N.Y.S.2d at 907-908, 613 N.E.2d at 938-939; *Winter-Wolff Int'l v. Alcan Packaging Food & Tobacco Inc.*, 499 F. Supp. 2d at 240-41. Since a claim for fiduciary duty is typically considered to be a tort, IDT Corp. v. Morgan Stanley Dean Witter & Co., 12 N.Y.3d 132, 140, 879 N.Y.S.2d 355, 907 N.E.2d 268, 272-73 (Mar. 26, 2009), Restatement (Second) of Torts § 874 ("Violation of Fiduciary Duty") (1979), and since the acts of Tzolis betraying his fellow members (and all other material acts relating to Vrahos and the Vrahos Lease, other than the formation of Vrahos in Delaware) involved in this litigation all took place in New York, therefore New York law should be applied. Also, the parties to this litigation signed all applicable documents in New York State, and, ordinarily, courts apply the law of the jurisdiction where a contract is signed when interpreting such contract. The Property is located in New York, which is another significant factor in the choice of law analysis.

The "Internal Affairs Doctrine" Does Not Require Delaware Law to be Applied

The Tzolis Memorandum argues at pages 3-4 that Delaware law should be applied because of the "internal affairs doctrine."[2] The "internal affairs doctrine" is "a conflict of laws

[2] Footnote 1 on page 4 of the Tzolis Memorandum cites *BBS Norwalk One, Inc. v. Raccolta, Inc.*, 60 F. Supp. 2d 123, 129 (S.D.N.Y. 1999) in support of the application of Delaware law. But the *BBS Norwalk* case merely applies

principle which recognizes that only one State should have the authority to regulate a corporation's internal affairs-matters peculiar to the relationships among or between the corporation and its current officers, directors, and shareholders-because otherwise a corporation could be faced with conflicting demands." *In re Adelphia Communications Corp.*, 365 Bankr. 24, 40 (Bankr. S.D.N.Y. 2007).

However, the New York State Court of Appeals, in *Greenspun v. Lindley*, 36 N.Y.2d 473, 477-478, 369 N.Y.S.2d 123, 330 N.E.2d 79 (1975), stated: "we reject any automatic application of the so-called "internal affairs" choice-of-law rule." In *In re Adelphia Communications Corp.*, 365 Bankr. 24, 41 (Bankr. S.D.N.Y. 2007), the court stated, "There is no reason to apply the "internal affairs" doctrine in this case since there "is no risk that different courts might reach different conclusions as to the applicable standards for appropriate officer or director conduct, or as to claims for failure to satisfy these standards." Since Tzolis caused Vrahos to sell the Lease, its sole asset, and Vrahos has effectively liquidated, and since the three members and managers of Vrahos are now parties to this litigation, there is no risk of inconsistent verdicts, and there is no risk of interference with the business of Vrahos, which is now dormant.

Also, Delaware is very deferential to contractual understandings of the parties, see tit. 6, § 18-1101(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") of the

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to a claim by an existing active corporation, owning an operating asset, that fiduciary duties owed to such corporation have been breached. Here, Messrs. Ifantopoulos and Pappas (i.e., individuals) are the parties claiming a breach of fiduciary duty, and the principal defendant (i.e., Steve Tzolis) is an individual, and Vrahos is now dormant, having sold its principal asset. Page 4 of the Tzolis Memorandum also cites *Trump v. Cheng*, 9 Misc. 3d 1120A, 862 N.Y.S.2d 812 (Sup. Ct., N.Y. Cty. 2005) in support of the application of Delaware law. However, this case involved a suit by Donald Trump on behalf of himself and also derivatively on behalf of 6 Delaware entities in a lawsuit against 5 individuals and 18 Delaware entities, which were involved in active transactions involving billions of dollars. Again, the only real parties of interest in this litigation are the 3 individuals who are before this court, and Vrahos has ceased its active business.

Delaware statutes (cited at page 4 of the Tzolis Memorandum). If, *arguendo*, Delaware law applies, then Delaware law would dictate the enforcement of the New York choice of law provision in the Vrahos Operating Agreement.

III.

UNDER DELAWARE LAW, MEMBER-MANAGERS SUCH AS TZOLIS ARE ALSO SUBJECT TO FIDUCIARY DUTIES

The Tzolis Memorandum (at pages 3-4) asserts that Delaware law, rather than New York law, should be applied. However, *Blue Chip* stated that a member of a Delaware LLC would have a remedy, under either Delaware or New York law, for breach of fiduciary duty even if all fiduciary duties had been waived, in the absence of proper disclosures to the waiving members. 299 A.D.2d at 280, 750 N.Y.S.2d at 294. Therefore, it does not appear to change the outcome in this case if Delaware law is applied instead of New York State law, although Plaintiffs Ifantopoulos and Pappas believe that New York State law is applicable for the reasons described above.

Nonetheless, since the Tzolis Memorandum, at pages 3-9, not only argues that Delaware law applies, but also mischaracterizes Delaware law, therefore we describe Delaware law below. Notwithstanding assertions at pages 4-6 and 8 of the Tzolis Memorandum to the contrary, Delaware, like New York, also applies fiduciary standards to members of an LLC. Fiduciary duties apply to member-managers, by "default" under the Delaware common law, unless and to the extent they are expressly waived. See, *Metro Communication Corp. BVI v. Advanced Mobilecomm Technologies Inc.*, 854 A.2d 121 (Ct. Chanc. Del. 2004), which applied fiduciary obligations to managers of Delaware LLCs by "default" since such obligations had not been waived. Metro (at fn 79) cited *Loudon v. Archer-Daniels-Midland Co.*, 700 A.2d 135, 137

(Del.1997) ("Delaware law of the fiduciary duties of directors ... establishes a general duty of directors to disclose to stockholders all material information reasonably available when seeking stockholder action.") and went on to state:

> … Furthermore, by contract - such as an exculpatory provision in a corporate charter or in an LLC Agreement - the beneficiaries may insulate their fiduciaries from liability for any breach of the duty of care, FN83 including one related to disclosure.FN84 In the alternative entity context, the beneficiaries may even go further and insulate them from claims for breach of the duty of loyalty, at least to some extent.FN85
>
> _____
>
> FN83. Exculpatory charter provisions may be enacted by corporations pursuant to 8 Del. C. § 102(b)(7). While the LLC Act contains no provision directly analogous to § 102(b)(7), it does provide that a "member's or manager's or other person's duties and liabilities [including fiduciary duties] may be expanded or restricted by provisions in the limited liability company agreement." 6 Del. C. § 18-1101(c)(2).
>
> * * *
>
> FN85. See Gotham Partners, L.P. v. Hallwood Realty Partners, L.P., 817 A.2d 160, 167-68 (Del.2002) (suggesting that there may be limits on the ability of parties to a limited partnership agreement to completely eliminate the fiduciary duties the general partner would otherwise owe to the other partners).

854 A.2d at 157. However, the Tzolis Memorandum erroneously states at p. 8 that if an LLC operating agreement is silent about the fiduciary obligations of the members, then no fiduciary obligations apply.

The *BBS Norwalk One* case cited by the Tzolis Memorandum (at page 4, fn 1) acknowledges that there is a remedy under Delaware law for breach of fiduciary duty and for aiding and abetting the same. The court further states that the law is materially the same in Delaware and New York. 60 F. Supp. 2d at 129-130. Similarly, in the *Trump* case cited by Tzolis (at page 4), the court acknowledged the existence of a remedy for breach of fiduciary duty under Delaware law. Id at ***11.

The Tzolis Memorandum (at page 4) states, "Under Delaware law, a limited liability company is solely a creature of contract," citing *Fisk Ventures, LLC*, 2008 Del. Ch. LEXIS 158. See also p. 5 of the Tzolis Memorandum. However, this is not the law, as described herein. Also, the applicable LLC operating agreement in *Fisk Ventures* stated that the parties had no duties to each other except as stated in the operating agreement; whereas the operating agreement of Vrahos had no similar provision. *Id.* at *42-*43. Further, the decision in *Fisk Ventures* is limited by the fact that the claimant in such case failed to allege facts supporting a breach of fiduciary duty, *id* at *34, *42, *45, whereas Messrs. Ifantopoulos and Pappas clearly have alleged such facts.

The Tzolis Memorandum (at page 5) cites *Bay Center Apartment Owner, LLC v. Emery Bay PKI, LLC*, 2009 Del. Ch. LEXIS 54 (Del. Ch. 2009). This case actually supports the position of Messrs. Ifantopoulos and Pappas, since the defendants had moved to dismiss the causes of action for breach of the implied covenant of good faith and fair dealing, and for breach of fiduciary duties, but the court denied the motion to dismiss, finding that one member of a Delaware LLC had stated a claim against the other member based on such causes of action. The Court also opined that the members of a Delaware LLC have fiduciary obligations to one another unless such obligations are explicitly disclaimed, stating (at pages 26-27):

> The Delaware LLC Act gives members of an LLC wide latitude to order their relationships, including the flexibility to limit or eliminate fiduciary duties. But, in the absence of a contrary provision in the LLC agreement, the manager of an LLC owes the traditional fiduciary duties of loyalty and care to the members of the LLC.

2009 De. Ch. LEXIS 54 at *26-*27 (footnotes omitted).

Assuming *arguendo* that Delaware law applies, Delaware law may in turn require the application of New York law because of the New York choice of law provision in the Vrahos Operating Agreement, as described above.

IV.

THE FIDUCIARY OBLIGATIONS OF TZOLIS WERE NOT WAIVED IN THE VRAHOS OPERATING AGREEMENT

The Tzolis Memorandum (at pages 4-8) argues that under Delaware law, the Vrahos Operating Agreement expressly waived all fiduciary duties of the member-managers in connection with a sale, and therefore no court can apply fiduciary duties to Tzolis. The Tzolis Memorandum (at page 5) argues that the *Sonet* case held that "contract principles 'preempt' fiduciary principles." This is not what this case actually said. What *Sonet* actually said is, in the context of a publicly traded Delaware limited partnership owning 2.4 million acres, "principles of contract preempt fiduciary principles where the parties to a limited partnership have made their intentions to do so plain." (emphasis added). 722 A.2d at 322. *Sonet* declined to impose additional implied fiduciary duties upon a general partner that was given "sole discretion" in the partnership agreement to approve a merger, since the merger was subject to a 66 2/3% supermajority of unit holders.

Tzolis, however, had not been given "sole discretion" to sell the property of Vrahos LLC behind the backs of his co-members, and such action was never approved by the required unanimous vote of the members or even disclosed or submitted for approval.

More importantly, even if action is taken pursuant to the express provisions of an LLC operating agreement, it may still be a breach of fiduciary duty. In *Blackmore Partners, L.P. v. Link Energy LLC*, 864 A.2d 80, 82 (Del. Chanc. Ct. 2004), the court refused to dismiss "breach of fiduciary duty" claims against the directors of a Delaware LLC, for approving a sale of substantially all of the assets of the LLC, even though, pursuant to the express terms of its operating agreement, the directors were empowered to effectuate such transaction without the consent of the unit holders.

Section 11 of the Vrahos Operating Agreement 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.

The Tzolis Memorandum asserts at p. 7 that the above Section 11 "unambiguously provides that a member owes no fiduciary obligations to the company or other members and may engage in business activities of any nature." However, this is a complete misinterpretation. The above Section 11 is a very standard clause that is inserted into most operating agreements and partnership agreements merely to permit each member and partner to carry on other business, even if technically competing, with the business being conducted by the LLC or partnership in question. It was not intended, as asserted at page 7 of the Tzolis Memorandum, as a general waiver of fiduciary obligations or any liability of Tzolis for self-dealing with respect to the business of Vrahos, and behind his co-members' backs. If this standard clause is decreed to be a general waiver of fiduciary obligations, then most LLCs would no longer be governed by fiduciary standards – which would be a very surprising and regrettable result.

Section 12 of the Vrahos Operating Agreement states in part:

> 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.** [Emphasis supplied.]

However, the Tzolis Memorandum ignores (when it summarizes Section 12 at page 7) the following critical provisions of this Section 12: (1) the "good faith" limitation, (2) the fact that this Section 12 is intended merely to protect a member or manager acting on behalf of Vrahos

pursuant to an express grant of authority in the Vrahos Operating Agreement, and (3) the "except" clause for fraud, bad faith or willful tortious misconduct.

Obviously, Tzolis was not acting in good faith, and Tzolis was clearly not authorized in the Vrahos Operating Agreement to exploit a lucrative business opportunity for Vrahos' property behind his partners' backs. Section 12 of the Vrahos Operating Agreement appears to be intended to apply to cases where one member takes action **on behalf of the LLC** pursuant to the authority granted in the Vrahos Operating Agreement – not the purchase by one member, on **his own behalf**, of the membership interests of other members. This is the difference between (1) acting on behalf of the LLC, and (2) exercising a right to make a transfer, on your own behalf, that is subject to a contractual prohibition (except for a limited exception thereto).

Further, the acts of self-dealing and fraud about which Messrs. Pappas and Ifantopoulos complain clearly fall within the above exception. The Tzolis Memorandum later, at p. 8, quotes provisions of the opinion in *Fisk Ventures* in support of its argument that such "except" clause does not create a "code of conduct." But Messrs. Ifantopoulos have never asserted that such "except" clause creates a "code of conduct." More importantly, the real issue is whether there has been any express waiver of all of the fiduciary obligations and duties of Tzolis. There has been no such waiver.

V.

THE 1/18/07 HAND-WRITTEN CERTIFICATE DID NOT WAIVE ALL OF TZOLIS' FIDUCIARY OBLIGATIONS

The Tzolis Memorandum (at page 9) asserts that Pappas and Ifantopoulos waived any fiduciary obligations of Tzolis by virtue of the hand-written Certificate that was dictated by Tzolis's counsel at the 1/18/07 meeting at which the assignments were signed and placed in

escrow. *Blue Chip* held that consent by a member to the self-dealing of another member is valid only if made after full disclosure is made to the consenting member, which disclosure was never made by Tzolis. The Certificate itself is therefore invalid because it was obtained without full disclosure. Also, as described in Section 22 of the Pappas Affidavit, this Certificate relates only to the January 18, 2007 assignments by Messrs. Pappas & Ifantopoulos; 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, or any other actions or omissions, 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 existing and future obligations. For example, Section 7 of the January 18, 2007 Agreement of Assignment and Assumption executed and delivered by Messrs. Pappas and Tzolis, and Vrahos (called the "Pappas assignment", a copy of which is annexed as Exhibit E to the June 10, 2009 affirmation of Eric Weinstein in support of the Defendants' motion to dismiss) 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 [and since the Effective Date did not occur by February 5, 2007, this assignment became void, pursuant to Section 9 of this assignment].

A comparable provision was contained in the assignment executed by Gus Ifantopoulos, a copy of which is annexed as Exhibit F to the June 10, 2009 affirmation of Eric Weinstein in support of the Defendants' motion to dismiss. However, the assignments by Messrs. Pappas and Ifantopoulos that were dated January 18, 2007 became void as of February 5, 2007 because,

pursuant to Section 9 of each assignment, 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. Section 9 of each assignment stated that the "Effective Date" occurred upon the happening of certain events, including the payment to Messrs. Ifantopoulos and Pappas of the purchase price of their interests in Vrahos, and the release of Steve Pappas under the Guaranty that he had delivered under the Lease. Since they did not receive such purchase price, and since Steve Pappas was not released under this guaranty, in each such case by February 5, 2007, therefore, such assignments became void as of February 5, 2007. A subsequent Estoppel Agreement dated February 14, 2007 among Messrs. Ifantopoulos, Pappas and Tzolis (the "Estoppel Agreement"), attached as Exhibit C to the Pappas Affidavit, 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 presumably 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, which specifically amended the assignments, failed to amend or make any reference to the Certificate. The Certificate literally applies only to the January 18, 2007 assignments that were signed transferring the interests of Messrs. Ifantopoulos and Pappas in Vrahos. Most importantly, the Certificate was not effective as a general waiver of any breach of fiduciary duties of Tzolis; and the Certificate did not by its terms apply to the Plaintiffs' separate claims for breach of fiduciary duty arising as the result of Tzolis' separate self-dealing (arising as the result of his secret exploitation for his own personal gain of an opportunity that belonged to Vrahos).

VI.

CLAIMS OF FRAUD, BAD FAITH AND BREACH OF FIDUCIARY DUTY WERE NOT WAIVED BY THE FEBRUARY, 2007 ESTOPPEL AGREEMENT EXECUTED AND DELIVERED BY PAPPAS AND IFANTOPOULOS

The Tzolis Memorandum (at pages 9-10) argues that that the February 14, 2007 Estoppel Agreement ratified the closing. However, as noted in the immediately preceding Section above, the Estoppel Agreement merely extended the deadline for taking the action required in order to make the assignments effective, and the Estoppel Agreement contains no general waiver or estoppel provisions. Whatever effect the Estoppel Agreement may have had on third parties, it did not amount to a general waiver by Pappas and Ifantopolous of their claims against Tzolis for his undisclosed self-dealing, including claims for fraud, breach of fiduciary duty and breach of the implied covenant of good faith and fair dealing.

VII.

THE SALE TO TZOLIS FAILED TO COMPLY WITH SECTION 14 OF THE VRAHOS OPERATING AGREEMENT

The Tzolis Memorandum (at page 8) asserts that members Pappas and Ifantopoulos waived the right of first refusal provisions in Sections 13-14 of the Vrahos Operating Agreement. However, the required notice of sale was never given by Tzolis pursuant to Section 14. The mere signatures by the non-transferor selling member on the assignments by the selling members did not qualify as a waiver of Section 14.

VIII.

PLAINTIFFS HAVE STATED A CAUSE OF ACTION IN EACH OF THE 11 COUNTS IN THE VERIFIED COMPLAINT

Defendants do not argue that the Plaintiffs have not stated a cause of action in any of the 11 counts of the Verified Complaint. Instead, the Defendants are claiming that even if the Plaintiffs have stated such 11 causes of action (in Counts 1-11 of their Verified Complaint), Tzolis has one or more defenses to such claims, particularly the claimed defense that he had no fiduciary duty to Vrahos or the Plaintiffs. These alleged defenses have been shown above to be without merit.

CONCLUSION

For the reasons set forth above, it is respectfully requested that the Defendants' motion be denied in its entirety.

Dated: **New York, New York**
July 23, 2009

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

	:	**Index No. 601115/09**
STEVE PAPPAS and CONSTANTINE IFANTOPOULOS, Individually, and Derivatively on Behalf of VRAHOS LLC,	:	
	:	**PROOF OF**
Plaintiffs,	:	**SERVICE**
	:	
-against-	:	
	:	
STEVE TZOLIS and VRAHOS LLC,	:	
	:	
Defendants.	:	
	:	

I, **Carl E. Person**, an attorney duly authorized to practice in the State of New York, do hereby affirm that the following is true under the penalty of perjury pursuant to CPLR 2106:

I am not a party to this action, am over 18 years of age, and on July 23, 2009, I served a true copy of the foregoing **OPPOSING AFFIDAVIT OF STEVE PAPPAS** (the "Document"), on the attorneys for the Defendants, by emailing and by mailing a copy of the Document to:

Eric Weinstein, Esq.
Yong Hak Kim, Esq.
Weinstein Smith LLP
420 Lexington Avenue – Suite 2620
New York NY 10170

Dated: New York, New York
July 23, 2009

By _____
Carl E. Person

Index No. 601115/09

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,	**:**
Plaintiffs,	**:**
-against-	**:**
STEVE TZOLIS and VRAHOS LLC,	**:**
Defendants.	**:**

MEMORANDUM OF LAW IN OPPOSITION TO DEFENDANTS' MOTION TO DISMISS UNDER CPLR 3211(a)(1) AND 3211(a)(7)

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