

CIRCUIT NOTES: SECOND CIRCUIT

Lack of Trust Precludes Breach of Fiduciary Duty Claim

Pappas v. Tzolis, ___ N.E. ___, 2012 WL 5906685 (N.Y. Nov. 27, 2012)

New York’s highest court dismissed a claim for breach of fiduciary duty asserted by two members of a limited liability company against the third member. *Pappas v. Tzolis*, ___ N.E. ___, 2012 WL 5906685 (N.Y. Nov. 27, 2012). In reaching that conclusion, the New York Court of Appeals pointed to the lack of trust between the plaintiffs and the defendant, and enforced an earlier written representation by the plaintiffs that no fiduciary duty was owed to them by the defendant.

The plaintiffs and defendant in 2006 formed a limited liability company (“Company”) for the purpose of entering into a long-term lease on a building. The plaintiffs contributed \$50,000 and \$25,000, respectively, to the company, and the defendant contributed \$50,000. Within a year of the Company’s formation, numerous business disputes arose between the plaintiffs and the defendant concerning the leased building, and the plaintiffs’ relationship with the defendant became antagonistic. The defendant then bought the plaintiffs’ interests in the company for a combined \$1.5 million. As part of the transaction, the parties executed a certificate in which plaintiffs represented that they had performed their own due diligence, had not relied upon any representation by defendant in entering into the agreement, and defendant owed no fiduciary duty to plaintiffs in connection with that transaction.

Six months later, the company assigned the lease on the building to a third-party for \$17.5 million. Plaintiffs later brought suit against defendant, alleging that his failure to disclose the negotiations with the third-party for the assignment of the lease when he bought their interests in the company was a breach of his fiduciary duty of disclosure to them. The defendant responded that the plaintiffs, by executing the certificate, released him from all claims based on a fiduciary duty.

In reversing the decision of a lower appellate court that refused to dismiss plaintiffs’ breach of fiduciary duty claim, the court turned to the principle that “where a principal and fiduciary are sophisticated entities and their relationship is not one of trust, the principal cannot reasonably rely on the fiduciary without making additional inquiry.” The plaintiffs concededly were sophisticated businessmen and their complaint and affidavits showed that plaintiffs’ relationship with defendant had become antagonistic “to the extent that plaintiffs could no longer regard [defendant] as trustworthy.” The release in the certificate was therefore valid and plaintiffs could not prevail on their breach of fiduciary duty claim. The court went on to add that “practically speaking,” the need to use care in assessing the lease’s value “should have been

obvious to plaintiffs, given that [defendant] offered to buy their interests for 20 times what they had paid for them a year earlier.”

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