| **Arel Capital Partners II LLC v HFZ Res Portfolio Holdings LLC** |
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| 2024 NY Slip Op 34204(U) |
| November 25, 2024 |
| Supreme Court, New York County |
| Docket Number: Index No. 653727/2021 |
| Judge: Andrew Borrok |
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INDEX NO. 653727/2021
RECEIVED NYSCEF: 11/25/2024

SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK: COMMERCIAL DIVISION PART 53

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AREL CAPITAL PARTNERS II LLC,

Plaintiff,

- v -

HFZ RES PORTFOLIO HOLDINGS LLC,HFZ RES PORTFOLIO MANAGER LLC,HFZ RES PORTFOLIO MEMBER LLC,HFZ RES PORTFOLIO INVESTOR LLC,HFZ CAPITAL GROUP LLC,ZIEL FELDMAN, NIR MEIR, JP MORGAN CHASE BANK N.A., MELODY BUSINESS FINANCE LLC,HFZ 76 11TH AVENUE JV LLC

Defendant.

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**INDEX NO.** 653727/2021

**MOTION DATE** 05/15/2024

**MOTION SEQ. NO.** 002

**DECISION + ORDER ON MOTION**

HON. ANDREW BORROK:

The following e-filed documents, listed by NYSCEF document number (Motion 002) 63, 64, 65, 66, 67, 68, 69, 70, 71, 72, 73, 74, 75, 76, 77, 78, 79, 80, 81, 82, 83, 84, 85, 86, 87, 88, 89, 90, 91

were read on this motion to/for JUDGMENT - SUMMARY.

Upon the foregoing documents, (i) Arel Capital Partners II LLC (**Arel**)'s motion for summary judgment for breach of fiduciary duty (third cause of action) as against HFZ Res Portfolio Manager LLC (**Res Manager**) and Ziel Feldman is GRANTED, and (ii) the defendants' (HFZ Res Portfolio Holdings LLC [**Res Holdings**], Res Manager, HFZ Res Portfolio Member LLC, HFZ Portfolio Investor LLC, HFZ Capital Group LLC, HFZ 76 11th Avenue JV LLC, and Feldman) untimely cross-motion for summary judgment is DENIED.

## THE RELEVANT FACTS AND CIRCUMSTANCES

As relevant to the defendants' breach of fiduciary duty, the record facts establish that the defendants took approximately $26 million of Net Surplus Refinancing Proceeds (the **Surplus**

**Proceeds**) in connection with a known 2016 cash-out refinancing (the **Refinancing**) of a portfolio of residential condominium development projects (the **Four Pack**) that Arel had an interest in, but unbeknownst to them and without their approval, and misappropriated that money to a totally different deal with different companies and different property outside of the Four Pack ownership chain to pay other money due JP Morgan Chase Bank N.A. (**JPM**).

The record evidence is bereft of anything which put Arel on notice ***of the misappropriation*** prior to 2020. The evidence only indicates that Arel understood that there was a cash-out by the Four Pack borrower entities, but nothing suggests that they knew anything at all about the misappropriation of $26 million (or would have put them on notice of the misappropriation) to a totally different project.

JPM who did the financing did not know about Arel's interest in the Four Pack Properties when they permitted Mr. Feldman and Res Manager (the manager) to use the borrower entities cash-out Surplus Proceeds to pay off unrelated debt owed to them because Mr. Feldman signed an Officer's Certificate (NYSCEF Doc. No. 75) in support of the JPM loan that certified that the operating agreement attached to it (which pre-dated Arel's interest) was the operating agreement then in effect. Thus, the Officer's Certificate failed to disclose the true, correct and complete Operating Agreement (the **OA**; NYSCEF Doc. No. 22) that was in effect at the time of the refinancing which OA included Arel as a Class B member and would have put JMP on notice of Arel's interest. This is all undisputed. Thus, there is no issue of fact that a breach of fiduciary duty occurred by the manager and that Mr. Feldman caused that breach to occur. This is a

different claim than merely the defendants did not comply with or otherwise breached Section 5.1 of the OA (*Id.* at 17).

Additionally, the record evidence demonstrates that in November 2016, when Arel inquired about the refinancing, the defendants misrepresented the very existence of the Surplus Proceeds. Specifically, the defendants provided Arel with a misleading email accompanied by an incomplete and inaccurate loan summary schedule that failed to reflect the existence of any surplus proceeds at all (NYSCEF Doc. No. 69). Moreover, the loan summary indicated that there was an approximately $100 million dollar deficit and that more funding was needed (*Id.*). Central to this concealment and misappropriation was Mr. Feldman himself. He was the party "in control" of Res Manager, the designated manager.

During discovery, Mr. Feldman conceded that among other things he controlled and signed the papers which facilitated the breach of fiduciary duty:

> Q. In fact you signed all of the closing documents for the refinance?
> A. Yes
> . . . .
> Q. Is that your signature under the various borrower entity?
> A. Yes.
> Q. So you signed the closing statement; did you not, for all of the borrowers?
> A. Yes
> . . . .
> Q. There was surplus proceeds of approximately twenty-six million dollars that went back to the borrowers; do you see that?
> MR. ROSS: Objection to the form. You can answer.
> A. Yes.
> Q. Now, were those monies received by the borrowers or were they paid elsewhere?
> MR. ROSS: Objection to the form. You can answer.
> A. I believe they were paid elsewhere.
> Q. The decision to pay them elsewhere was made by you?
> A. I was part of the decision, yes.

(NYSCEF Doc. No. 72 at 8-12).

There are also no factual issues as to the diversion of money to the XI project (which XI project is not part of the Four Pack properties or otherwise owned by the borrowers for the Four Pack Properties). Mr. Feldman conceded that too:

> Q. What was the purpose of that money? How was it applied?
> A. How was the money applied?
> Q. Yeah, the twenty-six million; was it a gift? Why did you give J.P. Morgan Chase twenty-six million dollars?
> A. It was employed to paydown a loan they had on another property.
> Q. And that other property is The XI?
> A. Correct

(*Id.* at 62).

In fact, the record evidence establishes that Arel only became aware of the $26 million diversion and misrepresentations in December 2020 when it acquired a copy of the executed closing statement prepared by Commonwealth Land Title Insurance Company (NYSCEF Doc. No. 70). The closing statement—signed by Mr. Feldman in eight different places—shows the availability of the Surplus Proceeds on the last line-item which reads: "Total Due to (from) Borrower - $26,044,212.84" (*Id.* at 2).

When Arel finally did learn of the diversion, on December 29, 2020, Arel sent a letter to Mr. Feldman, presenting the closing statement, calculations of the distributions which should have been made to Res Holdings and then to Arel, and made a demand for payment of Arel's share of the distribution in the sum of $7,263,200 (NYSCEF Doc. No. 71). There is no record documentary evidence that Mr. Feldman ever even responded to Arel's demand.

On June 10, 2021, Arel timely commenced this action against the HFZ-related defendants, Mr. Feldman, Nir Meir, and JPM, alleging breach of contract, fraud and concealment, breach of fiduciary duty, civil conspiracy, aiding and abetting, tortious interference, unjust enrichment, constructive trust and fraudulent conveyance (NYSCEF Doc. No. 2).

During the course of discovery in this case, Mr. Feldman was deposed. At his deposition when counsel for Arel inquired as to XI and the ownership structure in XI, counsel to Mr. Feldman both admitted that money was improperly diverted and also cut off those questions as to the ownership structure of XI indicating that those questions were out of bounds:

Q. Is this the Org Chart of The XI?
A. It appears to be, yes.
Q. And that's the same the XI that received the benefit of twenty-six million 16 dollars out of the 2016 refinancing, correct?
A. Is it the same XI?
Q. Yeah, the same project, the XI on 11th Avenue?
A. It's the same project, yes.
Q. Is Arel Capital involved in The XI at all?
A. I believe they are.
Q. Where are they involved?
A. Where are they involved?
Q. Yeah.
A. In this chart –
Q. Yes.
A. Or generally? You have to show me the Partnership Agreement. They also appear on the chart. They appear on the chart as a Class A Member.
Q. What was their involvement?
A. They made an investment in the acquisition of The XI.
Q. Were you involved in recruiting them to make that investments?
A. No.
Q. Who was?
A. Nir Meir.
Q. How much was their investments in The XI?
MR. ROSS: Objection, I'm shutting it down, Kevin. This has nothing to with this case.
Q. How much was their investment in The XI?
MR. ROSS: You don't know how much your client is invested in The XI, Kevin?
MR. NASH: I'm asking the questions, Mr. Feldman will answer the questions.
MR. ROSS: He's not, he's not.

MR. NASH: You can a make an objection.
MR. ROSS: Show me in the complaint how this has anything to do with it.
MR. NASH: The whole complaint is monies went from The Four Pack improperly to the XI, okay?
MR. ROSS: We already said that.
MR. NASH: So what was the –
***MR. ROSS: Let me finish. We have already said that, and that the wire transfer shows that that happened***, so –
MR. NASH: Okay.
MR. ROSS: ***I'm shutting down your question. Do you want to call the judge right now and ask him if you keep asking these questions?***
MR. NASH: If you want, we will call the judge when I'm done.
MR. ROSS: Okay.

(NYSCEF Doc. No. 87 at 80-83 [emphasis added]).

By Decision and Order, dated August 15, 2022 (the **Prior Decision**; NYSCEF Doc. No. 30) the Court granted JPM's motion to dismiss, finding, among other things, that the complaint's mere conclusory statements regarding JPM's knowledge or duty to know of Arel's rights to Surplus Proceeds were "insufficient to ground liability" given the circumstances (NYSCEF Doc. No. 30, at 2). The Court also dismissed the causes of actions for (i) civil conspiracy, aiding and abetting breach of fiduciary duty, and tortious interference; (ii) unjust enrichment and a constructive trust; and (iii) fraudulent conveyance as against JPM (*Id.*). In 2022, Arel filed a separate action to recover JPM's receipt of the Surplus Proceeds (Index No. 160441/2022). The Court dismissed JPM from that case too.

Pursuant to a case management order (NYSCEF Doc. No. 58), dated January 25, 2023 in the instant case, the Court required that note of issue be filed by April 2, 2024 and that dispositive motions must be filed within 30 days of the filing of note of issue. Subsequently, note of issue in this case was filed on April 1, 2024 (NYSCEF Doc. No. 59). Pursuant to a stipulation (NYSCEF

Doc. No. 62), dated April 26, 2024, the parties agreed to extend the time to file dispositive motions from May 1, 2024 until May 15, 2024 due to a death in plaintiff counsel's family. Thereafter, Arel moved for summary judgment on May 15, 2024 (NYSCEF Doc. No. 63). The defendants did not file a motion for summary judgment as of that date (or a cross-motion as of that) or within an appropriate amount of time thereafter. Indeed, they filed an untimely cross-motion as of July 11, 2024 seeking (i) dismissal of Arel's third cause of action for breach of fiduciary duty against all defendants; (ii) dismissal of the first cause of action for breach of contract as against HFZ Capital Group LLC, Res Manager, Feldman, HFZ Res Portfolio Member LLC, HFZ Portfolio Investor LLC, and HFZ 76 11th Avenue JV LLC; (iii) dismissal of the second cause of action for fraud and concealment as against all defendants; and (iv)-(v) dismissal of the fourth cause of action for civil conspiracy and the ninth cause of action for fraudulent conveyance as against all defendants, "primarily on the basis that this Court already dismissed same in [the Prior Decision]" (NYSCEF Doc. No. 78).

**DISCUSSION**

On a motion for summary judgment, the movant "must make a *prima facie* showing of entitlement to judgment as a matter of law, tendering sufficient evidence to demonstrate the absence of any material issues of fact" (*Alvarez v Prospect Hosp.*, 68 NY2d 320, 324 [1986], citing *Winegrad v New York Univ. Med. Ctr.*, 64 NY2d 851, 853 [1985]). The opposing party must then "produce evidentiary proof in admissible form sufficient to require a trial of material questions of fact" that its claim rests upon (*Zuckerman v New York*, 49 NY2d 557, 562 [1980]).

To prevail on a breach of fiduciary duty claim, a plaintiff must establish (i) that a fiduciary duty existed at the time of the breach, and (ii) that the defendant breached that duty (*McKenna v Singer*, 2017 WL 3500241, at * 15 [Del Ch Ct 2017]; *see also, William Penn Partnership v Saliba*, 13 A3d 749, 756 [Del 2011] [noting that unless expressly modified in the operating agreement, managers of a Delaware limited liability company owe traditional fiduciary duties of loyalty and care to the members of the LLC]).

The OA defines the "Manager" as Res Manager. Section 6.1 provides that

> [t]he manager shall conduct or cause to be conducted the management of the Company with a standard of care…typically required for managers or managing members of similarly situated limited liability companies for entities that directly or indirectly own and develop real estate projects in the Borough of Manhattan similar to the Property and have similarly situated sophisticated members with membership interests and rights similar to those of the Members of this Agreement, which shall include, without limitation, making full disclosure of any material conflicts of interest, not engaging in any transaction with related parties on other than arms' length terms, and performing its duties for the benefit of the Company as a whole rather than for the benefit of the Manager or any of its Affiliates…

(NYSCEF Doc. No. 22 § 6.1). Under Delaware law, limited liability companies owe the same fiduciary duties that corporate directors owe to their shareholders -- *i.e.*, the duties of loyalty and care (*Stone v Ritter*, 911 A2d 362, 370 [Del 2006]; *Polk v Good*, 507 A2d 531, 536 [Del. 1986]). The duty of loyalty "requires that directors act in the best interest of the company and prohibits them from using their positions as directors to further their own self-interest" (*Kahn v Portnoy*, 2008 WL 5197164, at *5 [Del Ch Dec. 11, 2008]). The duty of loyalty also requires fiduciaries to act in "good faith" to advance the interests of the beneficiary (*U.S. W., Inc. v Time Warner Inc.*, 1996 WL 307445, at *21 [Del Ch June 6, 1996]). The duty of care and its associated business judgment rule create a presumption that in making business decisions, the directors of a

corporation (or in this case the managers of limited liability companies) act on an informed basis, *i.e.*, with due care, in good faith, and in the honest view that their action was in the best interest of the company (*Cede & Co. v Technicolor, Inc.*, 634 A2d 345, 360 [Del 1993], *decision mod on rearg*, 636 A2d 956 [Del 1994]). Thus, Res Manager owed fiduciary duties to Arel, the class B minority interest holder. As discussed above, the record evidence establishes that the Surplus Proceeds were diverted from the Four Pack borrowers to pay off unrelated debt on a separate project. Unquestionably, this was a breach of fiduciary duty. Worse, the record evidence demonstrates that the very existence of Available Cash was misrepresented by HFZ Capital Group in its communications with Arel in connection with the refinancing. The record evidence also firmly establishes Mr. Feldman's control over Res Manager and his participation in the diversion of funds. Among other things, as discussed above, he both misrepresented the existence of Available Cash for distribution to the members after the 2016 refinancing and he submitted a false and misleading Officer's Certificate (which the lender was entitled to rely on) which did not disclose Arel's interest (because the wrong operating agreement was attached) to circumvent Arel's priority rights to the proceeds.

In their opposition papers, the defendants fail to raise an issue of fact warranting further proceeding. In sum and substance, they argue that the claim is untimely because the evidence shows that Arel understood there was a refinancing in 2016. But this misses the point. As discussed above, however, they adduce nothing which indicates that anything put Arel on notice of the $26 million misdirection. Thus, the argument fails. They also argue that the claim is duplicative of the breach of contract claim. As discussed above, it is not.

Indeed, there is no issue of fact that Arel only became aware of the misconduct in December 2020 when it obtained a copy of the closing statements relating to the Refinancing which reflected the availability of the Surplus Proceeds, stating "Total Due to (from) Borrower - $26,044,212.84" (NYSCEF Doc. No. 70 at 2). Arel promptly brought this lawsuit on June 10, 2021, well within the statute of limitations (*Van Lake v Sorin CRM USA, Inc.*, CIVA 12C04036JRJCCLD, 2013 WL 1087583, at *7 [Del Super Ct Feb. 15, 2013] [explaining that the statute of limitations is tolled until the plaintiff discovers the facts that constitute a basis for the cause of action, or discovers facts sufficient to put the plaintiff on inquiry notice, which, if pursued, would lead to the discovery of such facts]). Thus, the claim is timely and there are no issues of fact that Res Manager and Mr. Feldman are liable for breach of fiduciary duty.

For the avoidance of doubt, Mr. Feldman can not escape liability under the circumstances for his role as the "party in control" of the manager (*Feeley v NHAOCG, LLC*, 62 A3d 649, 670 [Del Ch 2012] [holding that Feeley could be held liable for breach of his fiduciary duty of loyalty as the party in control of AK-Feel, which in turn was the managing member of Oculus]). Mr. Feldman was the "party in control" of both Res Holdings and Res Manager; he signed the OA, all of the refinancing loan documents, the closing statement, and the Certificate, and, as discussed above, admitted to taking part in the misdirection of the Surplus Proceeds "elsewhere." He is also not entitled under the circumstances to now avert responsibility by blaming non-party Mayer Brown LLP for attaching the wrong operating agreement. It was incumbent upon him ensure the correct agreement was attached disclosing Arel's interest. Knowing that Arel was a class B member, he was required to either obtain their informed consent or otherwise to not cause the misdirection of $26 million out of the Four Pack ownership stack.

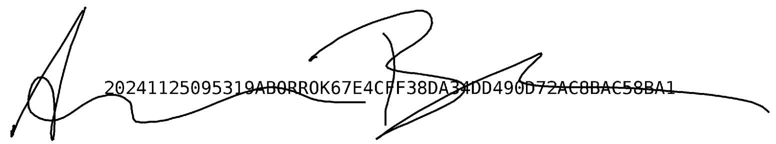
Finally, the Court notes that having cut-off discovery as to the ownership structure on the XI property, the defendants can not now use the ownership structure at XI as a shield to liability here. It is also irrelevant that Mr. Feldman did not physically put the $26 million directly into his own pocket and instead caused it to be redirected to pay the debts of another of his companies that owed money.

Lastly, the Court notes that the defendants' cross-motion must be denied for three reasons. First, it does not comply with the Part 53 Rules (the **Part Rules**; Practices-Part-53.pdf). The Part Rules state that "No cross-motions for summary judgment will be permitted." (*Id.* at Motion Practice ¶ 3). Second, the cross-motion was filed more than 30 days following NOI and after the stipulated extension to file dispositive motions. Third, even if considered, it would be denied for the reasons set forth above.

The Court has considered the parties' remaining arguments and finds them unavailing.

Accordingly, it is ORDERED that the Arel's motion for summary judgment is GRANTED and Arel may submit judgment ; and it is further

ORDERED that the defendants' cross-motion for summary judgment is DENIED.




11/25/2024
DATE

ANDREW BORROK, J.S.C.

CHECK ONE: [X] CASE DISPOSED [ ] NON-FINAL DISPOSITION