STATE OF NEW YORK
SUPREME COURT : COUNTY OF ERIE

McGUIRE CHILDREN, LLC, SENECA AMHERST LAND CORP. and FRANK McGUIRE

Plaintiffs,

MEMORANDUM DECISION

vs.

Index No. 1999/04

WILLIAM L. HUNTRESS, WAYNE I. EISENBAUM, ACQUEST HOLDINGS, INC., ACQUEST DEVELOPMENT, LLC, ACQUEST GOVERNMENT HOLDINGS, LLC, ACQUEST GOVERNMENT HOLDINGS, II, LLC, ACQUEST HOLDINGS, FC, LLC, ACQUEST GOVERNMENT HOLDINGS, OPP, LLC, ACQUEST GOVERNMENT HOLDINGS U.S. GEOLOGICAL, LLC, AND LINCOLN PARK ASSOCIATES, LLC

Defendants.

BEFORE: **HON. JOHN M. CURRAN, J.S.C.**

APPEARANCES: **MATTAR, D'AGOSTINO & GOTTLIEB, LLP**
Attorneys for Plaintiff
Lawrence J. Mattar, Esq., of Counsel
Thomas C. D'Agostino, Esq., of Counsel
Krista Gottlieb, Esq., of Counsel

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Attorneys for Defendants
Michael A. Brady, Esq., of Counsel

CURRAN, J.

Plaintiff, McGuire Children, LLC ("McGuire Children" or "Plaintiff"), commenced this action in 2004 alleging that defendant, William L. Huntress ("Huntress"), individually and through the other defendants in this action, perpetrated a “major fraud” upon Plaintiff. Specifically, McGuire Children alleges that Huntress induced it to provide “significant monies” to enable Huntress to make various investments in real estate; subsequently convinced Plaintiff that these investments “were unprofitable and/or losing money;” and, after causing Plaintiff to liquidate its interests in those investments, Huntress then allegedly “flipped” and re-sold those investments for a “significant profit” which he kept for himself (Amended Complaint, ¶ 1).

Plaintiff’s Amended Complaint alleges nine (9) causes of action: (1) breach of contract; (2) breach of implied covenant of good faith and fair dealing; (3) breach of fiduciary duty; (4) fraud and constructive fraud; (5) rescission; (6) declaratory judgment; (7) constructive trust and accounting; (8) interference with, or conversion of, corporate/business opportunities; and (9) negligent misrepresentation.

Plaintiff seeks compensatory damages in the sum of at least $42 million and punitive damages in the sum of at least $10 million. Plaintiff also requests declaratory relief, the imposition of a constructive trust, an accounting, and other incidental equitable relief.

Defendants allege that all of these causes of action are barred by the provisions of a General Release executed in March of 2002. Defendants also have counterclaimed for attorneys’ fees which are authorized by the terms of the General Release in the event that litigation is commenced in connection with the claims thereby released.

Following the Court’s decision on the defendants’ motion for summary judgment, the action proceeded to a non-jury trial on December 8-12 and 15-17, 2008. The parties thereafter submitted proposed findings at which time decision was reserved.

At the commencement of the trial, the parties agreed that the critical issue was whether Huntress had engaged in fraud and/or breached his fiduciary duties which, under Plaintiff's theory, would render the General Release now voidable. For the reasons explained in the record, the Court on its own motion bifurcated the trial and proceeded solely on liability issues. The issue of appropriate remedies, if any, was reserved for further proceedings.[1]

At the commencement of the action, the parties stipulated to discontinue on the merits as against defendant, Wayne I. Eisenbaum ("Eisenbaum"). At the close of the proof, the parties stipulated to discontinue on the merits as to Plaintiffs, Frank McGuire and Seneca Amherst Land Corp. ("SALC"), leaving McGuire Children as the only remaining Plaintiff. Based on previous stipulations, the remaining defendants in the action are: Huntress; Acquest Holdings, Inc. ("AHI"); Acquest Development, LLC ("Acquest Development"); Acquest Government Holdings OPP, LLC ("OPP"); Acquest Government Holdings U.S. Geological, LLC ("USGS"); and Lincoln Park Associates, LLC ("Lincoln Park").

FACTUAL FINDINGS

The business relationships involved in this action arise from the friendship between Frank McGuire and Huntress. Both men testified that they were very close friends at one point. Their friendship arose in the early to mid-1990's shortly after Huntress moved in across the street from Frank McGuire. Huntress joined the Country Club of Buffalo at about the same time and became a golfing partner of Frank McGuire. These gentlemen took

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[1] This includes the relief sought in the Fifth (rescission), Sixth (declaratory judgment), and Seventh (constructive trust and accounting) causes of action. This Decision addresses the remaining causes of action to determine if there is a basis upon which to hear evidence concerning appropriate remedies.

vacations together and frequently socialized with one another. Huntress referred to McGuire as a “life friend” and testified that they had a “pretty close” relationship. Frank McGuire confirmed that they were very close friends and they did a lot of things together. Frank McGuire repeatedly testified that he trusted Huntress until their falling out.

Frank McGuire described his business interests, including serving as a “bank” to people since approximately the mid-1980's or thereabouts. Around the time of the transactions underlying this lawsuit, Frank McGuire had a net worth of approximately $100,000,000.

Huntress initially sought to interest Frank McGuire in a business transaction involving an investment in a sign company. Frank McGuire declined. Thereafter, in April of 1997, Huntress called Frank McGuire to borrow some money with respect to real estate Huntress sought to acquire through Acquest Properties, Inc., located at 2220 Wehrle Drive in the Town of Amherst (“Wehrle Drive parcel”). Huntress needed the money the next day. McGuire agreed to make the loan in the sum of $485,982.67 (Ex. 1). Frank McGuire was to be paid 15% interest on the repayment of the loan. After the closing on the Wehrle Drive parcel, Huntress sent a letter to Frank McGuire stating: “Frank I can’t thank you enough! YOUR [sic] THE MAN!” (Ex. 2).

The agreement entered into between Huntress and Frank McGuire in April of 1997 (Ex. 1) afforded Frank McGuire the right to select between two options. Frank McGuire testified that he did not choose either of those options because, as far as he was concerned, the arrangement was solely that Huntress would repay him his money in full plus 15% interest. Exhibit 1 provides in pertinent part that, under Option II, Frank McGuire and Huntress would become partners in the ownership of the Wehrle Drive parcel and that Frank McGuire would be entitled to a 25% interest in the "Acquest Holdings Fort Collins projects."

Huntress sought to continue his business arrangements with Frank McGuire by forwarding him a check for $175,000 on property in which Huntress had been involved in Jacksonville, Florida. Eisenbaum objected to the payment because he did not think Frank McGuire was a partner in that project. Nevertheless, Huntress sent the check to Frank McGuire which McGuire promptly returned. According to Frank McGuire, he was not Huntress' partner. Frank McGuire was willing to work with Huntress on "some jobs" but could not become Huntress' partner because McGuire at that time was partners with some of Huntress' competitors in the Buffalo area.

Later in 1997 or early in 1998, Huntress told McGuire that it looked like Huntress was going to be awarded the Fort Collins project and that Frank McGuire owned 25% of it. Frank McGuire testified that this surprised him because he had never exercised the option referred to in Exhibit 1.

The Fort Collins project was one sponsored by the federal government involving the construction and lease back to the government of the Wildlife Science Building ("WSB") located in Fort Collins, Colorado. This was the first of five (5) such government-sponsored projects in which the McGuire interests and Huntress became involved and which are the focal points of this lawsuit.

Under the arrangement with the federal government, Huntress was required to construct the buildings and lease them back for 20-year terms to the government. Each such project was estimated by Huntress to cost between $15 million and $20 million to construct.

The first of these five (5) projects was WSB. Frank McGuire testified that he provided assistance to Huntress in connection with negotiations involving the general contractor for WSB and otherwise contributed his construction expertise to that project. Once the construction was underway, Huntress expressed his gratitude to Frank McGuire by unilaterally increasing Frank McGuire's interest in the WSB project from 25% to 35%.

In order to memorialize the parties' understanding, Huntress formed Acquest Holdings FC, LLC (Ex. 3), as the owner of WSB. The operating agreement for this limited liability company provides that Huntress and Eisenbaum are the managers as well as members along with McGuire Children. Even though it was Frank McGuire who was entitled to the ownership interest in the WSB project, Huntress afforded Frank McGuire the right to assign the 35% interest to an entity he selected. Frank McGuire selected McGuire Children as the recipient of that assignment as part of his estate planning process. McGuire Children exists for the purpose of providing Frank McGuire's children with investments and income.

Approximately one (1) year after the WSB project was begun, Huntress approached Frank McGuire with another government-sponsored project to be built in Chelmsford, Massachusetts for the Environmental Protection Agency ("EPA"). Huntress needed to borrow $1 million which Frank McGuire agreed to provide in order to preserve Huntress' ability to pursue the EPA project. The parties entered into an operating agreement for the owner of that project, Acquest Government Holdings, LLC, which was later amended and restated in December of 1999 (Ex. 5). McGuire Children received a 35% ownership interest in the EPA project.

At approximately this same time in 1998, the parties formally established their lending arrangement in a Revolving Credit and Term Loan Agreement, later amended and restated in December of 2000 (Ex. 9) ("Loan Agreement"). The Loan Agreement confirmed that the lender was SALC, which is wholly-owned by Frank McGuire. The borrower was initially Acquest Government Holdings, LLC (the owner of the EPA project) but was restated to be Acquest Development. The Loan Agreement provided SALC with repayment of its loan plus between 12% and 15% interest. The Loan Agreement further provided SALC the right to assign its option to purchase, for $1.00, a 35% interest in any government-sponsored lease project entered into between Frank McGuire and Huntress.

Between 1999 and 2001, such arrangements were entered into with respect to three (3) other government projects: DEA (located in Largo, Maryland); USGS (located in Fort Collins, Colorado); and OPP (located directly next to WSB in Fort Collins, Colorado). Separate and stand-alone limited liability companies ("LLCs") with separate operating agreements were formed for each one (Ex. 4 [DEA]; Ex. 6 [USGS]; and Ex. 7 [OPP]). Each such entity (including WSB and EPA) was jointly and severally obligated to repay all amounts advanced by SALC pursuant to the Loan Agreement (Ex. 9). While this obligation could result in McGuire Children losing its equity interest in the LLCs, McGuire Children had no obligation to re-pay the loans to SALC or make any capital contributions to the LLCs. The ownership interests in the LLCs given to McGuire Children were "equity kickers" as part of the consideration for Frank McGuire's loans through SALC.

In addition to the Wehrle Drive parcel and the five (5) government-sponsored projects, the parties entered into business arrangements with respect to two (2) other projects. McGuire Children loaned $700,000.00 in 1998 and 1999 to Lincoln Park Associates (pertaining to a development project in Rochester, New York) and received a 45% equity stake in that project. This too was a stand-alone LLC with no obligations to the other LLCs.[2] Huntress also gave a 35% equity interest to McGuire Children in the Crosspoint project (referred to in Ex. 1), although neither SALC nor McGuire Children loaned any money in connection with it. The ownership interest in Crosspoint was provided as a further incentive for Frank McGuire's loans through SALC.

According to the Loan Agreement, the loans to Acquest Development were made pursuant to a Term Promissory Note ("Term Note") (Ex. 10) and a Revolving Promissory Note ("Revolving Note") (Ex. 11). Acquest Development first drew down on the Revolving Note in September of 1998 and the last draw, to the full limit of $2 million, was in February of 1999 (Ex. 11). Acquest Development's first draw on the Term Note was in February of 1999 and six (6) loans were made thereon between then and October of 1999. One (1) payment was made in March of 2000. In November of 2002, Acquest Development borrowed an additional approximately $44,000. Other than this additional $44,000 in November of 2002, Huntress had borrowed the entire $1.4 million available under the Term Note by the end of 1999 (Ex. 10).

The sequence of the projects was that WSB was completed in 1998, generating lease income shortly thereafter. The EPA and DEA projects arose in 2000. The OPP and

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[2] The operating agreement for this LLC is not in the record.

USGS projects arose in early 2001. By the time the OPP and USGS projects arose, Huntress no longer had the ability to draw on any further loans from SALC pursuant to the Loan Agreement. Other than WSB, all of these projects were still in the construction phase through 2001.

The parties agree that Huntress took on the government projects too quickly and with too little capital. The parties further agree that, by 2001, Huntress was in serious financial jeopardy with respect to the four (4) projects still under construction.

The DEA and EPA project costs ran significantly over budget because of their complexity and, as admitted by Huntress, his lack of experience with those types of laboratory facilities. The OPP and USGS projects were not nearly as complicated as EPA and DEA but, because Huntress was under-capitalized and the projects grew too fast, he needed to borrow additional money for those two (2) projects from SALC in May of 2001. Huntress borrowed $1 million from SALC and he and Eisenbaum personally guaranteed repayment and pledged their membership interests in OPP and USGS. They also provided McGuire Children with an additional 5% interest in each of those projects such that McGuire Children owned 40% of OPP and USGS while continuing to own 35% of WSB, EPA and DEA. At the same time, Frank McGuire's son, Jim McGuire, who is the managing member of McGuire Children, together with SALC's internal accountant, Matt Turk ("Turk"), assumed check-signing authority for OPP and USGS.[3] This $1 million loan was repaid by August of 2001, plus interest and the personal guarantees of that loan and the pledges were rescinded.

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[3] Turk had previously told Huntress' in-house accountant to treat Turk as an "auditor" for purposes of providing the McGuire interests with financial information about the projects in which the McGuires had invested.

According to Huntress, by August of 2001, “things were pretty ugly” and he was in very serious financial trouble. The DEA and EPA projects were in the most difficulty in that Huntress was late on payments to construction companies and contractors were threatening to walk off the jobs. His construction financing lenders were considering not funding any more and there was a possibility that one of Frank McGuire’s letters of credit would be drawn upon.

Neither Frank McGuire nor Jim McGuire disputed the truthfulness of Huntress’ claims that he was in dire financial straits in the second half of 2001. Jim McGuire confirmed at trial that EPA and DEA were each $3 million over budget. He also had concerns about the depth and capabilities of Huntress’ management team. Frank McGuire shared these serious concerns and acknowledged that Huntress had essentially run out of money. Huntress even had to borrow $125,000 from Frank McGuire to pay off his personal credit cards which he was using to travel across country to deal with the projects’ problems. Turk further confirmed the McGuires’ great concerns about Huntress’ viability, including the possibility of a bankruptcy. Turk’s own evaluation of the DEA and EPA projects revealed there was no equity in them due to cost overruns.

Huntress approached M&T Bank in the summer of 2001 to procure a loan to replace SALC as his lender. M&T Bank declined to do so unless McGuire Children agreed to guarantee the loans along with Eisenbaum and Huntress on a joint and several basis. McGuire Children refused unless it was on a pro rata basis. M&T Bank denied the loan.

It was at this same time that the personal rift between Huntress and Jim McGuire began to reveal itself because, during the discussion of the M&T Bank proposal, Jim McGuire appears to have insulted Huntress. Jim McGuire sought to explain to Huntress the difference between a pro rata guarantee and a joint and several guarantee. Huntress testified sardonically that he knew the difference.

The developing personal rift between Jim McGuire and Huntress is clearly evident in a letter dated September 6, 2001 (Ex. E-1). There, in a letter to Huntress, Jim McGuire stated:

> I am concerned that your continued aggressive behavior, and attempts to redefine the nature of the relationship between our companies, is eroding any chance of returning to the amicable relationship that once existed.

(Ex. E-1, p. 1). The letter also describes Jim McGuire's concerns that Huntress is portraying himself as in partnership with the McGuire interests and could thereby seek to call upon the McGuires to make a capital contribution as opposed to a loan. Jim McGuire wrote:

> It seems apparent to everyone else involved, including your partner Wayne, that the nature of the relationship from the outset was clearly represented in the documents, and that McGuire entities were acting as lenders with a "kicker" of equity participation in successful projects.

(Ex. E-1, p. 1).

After this letter, the McGuires asked Huntress and Eisenbaum to sign an estoppel letter which sought to firmly describe the nature of the business relationships (Ex. E-2). The estoppel letter, drafted by the McGuires' attorney, confirms the amount of indebtedness owed to SALC. Its purpose was to make clear that the McGuire interests were not viewed as a partner with Acquest Development (the borrower from SALC) in case it failed financially. The estoppel letter states:

> We [Huntress and Eisenbaum] acknowledge that neither you, nor your children, nor any entity you or your children own or control (collectively "McGuire Entity"), are partners or joint ventures with Acquest Development, LLC.

(Ex. E-2, p. 2). According to the testimony at trial, the documents referred to are the Loan Agreement and the operating agreements for each of the five (5) limited liability companies involved in the government-sponsored projects. Huntress testified he was "pretty much forced to sign" the estoppel letter.

On September 28, 2001, Huntress proposed that SALC loan an additional $1.8 million to allow him to complete the EPA and DEA projects (Ex. 26). Huntress proposed a 16% interest rate over a six-month term. He also offered an additional 5% ownership interest in USGS and OPP if the loan was not repaid in 90 days and stock pledges for both of those entities until the loan was repaid.

In response, by letter dated October 2, 2001 (Ex. 27), SALC proposed to loan Huntress $625,000, well short of the amount Huntress sought. Moreover, the offer from SALC would require Huntress to transfer 100% of all ownership interests in USGS, OPP, WSB and Lincoln Park. Turk testified that these were the valuable projects and that Huntress would be left only with the projects which were experiencing the most serious problems (i.e., DEA and EPA). The letter from SALC demanded that Huntress respond in 24 hours.

Huntress testified that, upon receipt of this letter (Ex. 27), he concluded that he had a serious problem with the McGuire interests and that he would need to replace them as his lenders as soon as possible. He immediately prepared correspondence to this effect (Exs. 28 & BH). Huntress testified that he viewed the letter from SALC as an "ultimatum" and that it was "criminal." Huntress also stated that he would not agree to such a deal "in a million years." While Huntress testified that he was not angry at this point, he stated that he was "very concerned." Huntress' denial of being angry about the letter is not credible because, as the

Court observed, Huntress was quite agitated on the witness stand as he described this "ultimatum" from the McGuire interests.

Shortly after Huntress received Exhibit 27, Huntress and Frank McGuire met at Frank McGuire's office. The exact date of the meeting is not in the record but was most likely on October 3 or 4, 2001.

Both men described this meeting in very similar terms. Huntress recalls that he was sitting at Frank McGuire's desk and that Frank was very concerned about cash flow for his other business interests. Frank McGuire also was very concerned about his exposure on the government projects. Specifically, the parties agree that Frank McGuire was exposed, under letters of credit and guarantees, to approximately $10 million in potential losses if all of the projects became worthless. At some point in the conversation, Huntress offered to pay off all of his indebtedness to SALC, remove Frank McGuire from any letters of credit and guarantees, and to dispose of the equity interests possessed by Plaintiff in the government and other projects. Essentially, the McGuire interests and Huntress would be parting ways completely. Huntress offered to do this within thirty (30) days. Frank McGuire thought about this proposal overnight, called Huntress the next day and accepted, provided that Huntress effectuated the arrangement within thirty (30) days.

There is some question in the record whether the McGuire interests agreed to Huntress finding a new "investor" or merely a lender providing a "straight loan." Turk testified that his notes, which he recorded on October 8, 2001 at the time he first spoke to Jim McGuire about the arrangement, referred to the word "investor" (Ex. F). Still, Turk opined that a "straight loan" was possible, an opinion Huntress termed "an absolute joke" given his extreme financial difficulties at the time. Similarly, Jim McGuire's letter dated October 10, 2001 (Ex. 32), uses the word "investor," although he too thought a "straight loan" was possible given that Huntress "is a charismatic person that has a way of making cavalier statements from time to time . . .." Frank McGuire testified that it would be within reasonable expectations for Huntress to find someone who would take an "equity kicker" similar to what he received in exchange for the loans provided by SALC. Nevertheless, Frank McGuire strongly objected to having another entity purchase any of the government-sponsored projects as part of buying out his interests and claims that any such purchase would be a significantly different arrangement.

Huntress testified that it was shortly after he made the buy-out arrangement with Frank McGuire that he first contacted iStar Financial ("iStar"), a national real estate investment trust ("REIT") to find replacement financing. iStar's representative, Cabot Lodge, testified at his examination before trial, relevant parts of which were received in evidence (Exs. 70 & BK), that he first heard from Huntress during a phone call in the fall of 2001. Lodge testified that this first call from Huntress "was right around 9/11" (Ex. 70, p. 24). Lodge also testified that he received his first written communication from Huntress, dated October 25, 2001 (Ex. 35), approximately two (2) weeks after the initial phone call.

Plaintiff relies upon Lodge's testimony about the first call being "right around 9/11" to argue that Huntress was already planning to make a sale to iStar, and thereby secure the profit on that sale solely to himself, even before he made the arrangement to buy out Frank McGuire in early October. Huntress claims that he did not make contact with iStar until after he and Frank McGuire made a deal to pay off the McGuire interests and to otherwise relieve Frank McGuire from any further obligations. Huntress emphasizes Lodge's testimony that the first contact with iStar was approximately two (2) weeks before the letter dated October 25, 2001.

On this point, the weight of the credible evidence is in Huntress' favor. Huntress' testimony on this issue was forthright and believable. It also was consistent with the documentary evidence. The first letter from Huntress to iStar is dated October 25, 2001, which Lodge testified was the ordinary sequence of such events where a telephone conversation is followed up with written information about the projects. Huntress' testimony is further substantiated by the logical conclusion that he would not seek to enter into a new deal to replace the McGuire interests until he knew for a fact that the McGuires would agree to such an arrangement.

The initial communications with iStar indicate that Huntress was seeking a lender to provide funds to pay off the McGuire interests. The record also reflects that, from the beginning, iStar was more interested in acquiring some or all of the government projects.

Huntress repeatedly admitted at trial that he specifically did not inform Frank McGuire, Jim McGuire or anyone representing the McGuire interests of this potential transaction with iStar.[4] Huntress further confirmed that he told Frank McGuire about everything important involving the government projects, except for the prospective deal with iStar. Huntress' only credible explanation as to why he withheld this information is that he was told by the McGuires that they did not care where the money was coming from to buy them out. Huntress also credibly acknowledged that his decision not to tell the McGuire interests about

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Huntress informed Eisenbaum of the iStar negotiations in about November of 2001. Eisenbaum was bought out by Huntress in March of 2002 for $250,000.00.

the iStar transaction "could have been" based in part on Jim McGuire's refusal to help Huntress correct the problems the projects were facing.

Frank and Jim McGuire testified that part of the deal with Huntress was that, if Huntress did not effectuate the buy-out within thirty (30) days, then Huntress would be required to take the McGuire offer whereby the McGuires would acquire the most valuable projects. Frank McGuire also intended to try to turn over the management of those projects which were still under construction to Larry Quinn, a local developer. Huntress disputes that this was part of the deal and it is clear that there was no written understanding agreed upon by the parties on this point.

Huntress proceeded with the iStar negotiations between October of 2001 through the closing with iStar in March of 2002. The deal with iStar appears to have progressed from a short-term loan (Ex. 36) to a loan coupled with iStar's option to purchase any of the projects (Ex. 37). Huntress testified that it was not until March of 2002 that the ultimate arrangement with iStar, involving iStar acquiring two of the projects at closing, was agreed upon.

Frank McGuire testified that he understood throughout the months of October of 2001 through March of 2002 that he was entitled in the Loan Agreement and operating agreements to default Huntress and take over the projects. The Term Note was due in January of 2002 and it was not repaid at that time.[5] Frank McGuire testified that he did not want "the

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[5] In January of 2002, in response to a demand by SALC, Huntress provided SALC with pledges for his and Eisenbaum's membership interests in OPP and USGS as further security for the indebtedness (Ex. 39). This is approximately coincident with the date upon which the Term Note was due.

grief," "turmoil" and "pain" involved in taking over the projects and defaulting his friend. He preferred instead to be bought out.

The closings with the McGuire interests and iStar occurred simultaneously on March 28, 2002. As part of those transactions, all of the loans owed to SALC were paid in full together with all interest. Frank McGuire confirmed that he earned just under $2 million on his investments with Huntress. The earnings included McGuire Children being paid slightly less than $1 million for its interest in three (3) of the LLCs for the government-sponsored projects, (albeit for tax purposes to lessen the capital gains paid by Frank McGuire). Further, Frank McGuire was relieved from all letters of credit and guarantees. Frank McGuire also was repaid the $125,000 he loaned to Huntress for the credit cards. In return, Huntress received control over all five government projects, together with Crosspoint, Lincoln Park and the Wehrle Drive parcel. This closing terminated any business relationship between Huntress, Frank McGuire and the other McGuire interests. Jim McGuire stated that the parting of the ways was on "bad terms."

There is nothing in the closing documents between the McGuire interests and Huntress requiring a "straight loan" or reserving to the McGuires any opportunity to share in any profits Huntress might realize in the future from a sale of the projects. There also is nothing in the documents disclosing the source of funds used by Huntress to close the transaction. In fact, both Frank McGuire and Jim McGuire repeatedly admitted they never asked.[6]

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[6] Frank McGuire wondered whether Huntress could borrow that much money, whereas Jim McGuire testified that he never gave it a thought.

Upon the closing with iStar, Huntress received sufficient funds to pay off the McGuires and to relieve Frank McGuire from his letters of credit and guarantees. As part of the transaction, Huntress was required to convey all of his interest in two (2) of the government projects (WSB and EPA) to iStar. The record reflects that a further government project (DEA) was conveyed to iStar in May of 2002. The agreement with iStar contained a number of "true up" conditions under which Huntress was required to complete construction of the projects and guarantee the income received from the projects for certain periods of time. All of the government projects, except WSB, were still incomplete as of the closing date.

At the McGuire/Huntress closing, the parties exchanged General Releases, drafted by Plaintiff's counsel. McGuire Children executed a release in favor of all the defendants providing for a release of all claims "known or unknown." The releases also provide for an award of attorneys' fees in favor of any releasee against any releasor who commences a suit relating to claims released.

About a month and a half after the closings, McGuire congratulated Huntress on being able to procure the financing to close the deal. Huntress responded in part by disclosing that the company which provided the money (iStar) had seen its stock go up by two (2) points since the closing. Frank McGuire determined that this must have meant that Huntress had sold the projects rather than just obtained a loan. It was then that Frank McGuire concluded that he had been cheated, and commenced this suit.

LEGAL CONCLUSIONS

A. Effect of the General Release

The parties agree that the language of the General Release at issue (Ex. C) is quite broad and encompasses all of the causes of action asserted by McGuire Children. Defendants have raised the release as an affirmative defense. Accordingly, McGuire Children must first demonstrate that the General Release is void/voidable in order to maintain the causes of action alleged in the Amended Complaint.

New York law holds that fraud in the inducement of a general release renders it void or voidable (*Kamerman v Curtis*, 285 NY 221, 225 [1941]; *Gilbert v Rothschild*, 280 NY 66, 71 [1939]; *Kirchner v The New Home Sewing Machine Co.*, 135 NY 182, 188 [1892]; *Global Minerals and Metals Corp. v Holme*, 35 AD3d 93, 98 [1st Dept 2006]). McGuire Children relies on actual or constructive fraud theories and does not allege fraud in fact. Therefore, the question is whether the release is voidable, not whether it is void (*Gilbert v Rothschild*, 280 NY at 71-72; *Kamerman v Curtis*, 285 NY at 225-226).

A release also is voidable if it was procured by the concealment of material facts in breach of a fiduciary duty (*Littman v Magee*, 64 AD3d 14, 17 [1st Dept 2008]; *H.W. Collections, Inc. v Kolbert*, 256 AD2d 240, 241 [1st Dept 1998]; *Matter of Birnbaum v Birnbaum*, 117 AD2d 409, 419 [4th Dept 1986]). Here, McGuire Children alleges that Huntress concealed material facts from it in breach of his fiduciary duties. Thus, the fundamental question is whether the General Release is voidable based on fraud in the inducement and/or breach of fiduciary duties.

The burden rests upon McGuire Children to establish the grounds to render the release voidable (*Marlow v Muhlnickel*, 294 AD2d 830, 831 [4th Dept 2002]; *Liling v Segal*, 220 AD2d 724, 725 [2d Dept 1995]; *Mergler v Crystal Properties Assoc., Ltd.*, 179 AD2d 177, 181 [1st Dept 1992]). The burden of proof under these circumstances is clear and convincing evidence (*Richman v. Albert*, 127 AD2d 992 [4th Dept], *lv denied* 70 NY2d 745 [1987]*; Chopp v Welbourne & Purdy Agency, Inc.*, 135 AD2d 958, 959 [3d Dept 1987]; *Mix v Neff*, 99 AD2d 180, 183 [3d Dept 1984]; *Rosenheck v Rosenheck*, 69 AD2d 878 [2d Dept 1979]).

Prior to trial, and as part of the summary judgment motions, the Court invited briefing on the issue of whether the language in the release concerning the release of all claims "known or unknown" changes the analysis concerning the ability of McGuire Children to seek a declaration that the release is voidable. The Court has concluded that that language under these circumstances does not change the analysis under New York law (*Global Minerals and Metals Corp.*, 35 AD3d at 96; PJI 4:11, p. 724; 19A N.Y. Jur. 2d, Compromise, Accord and Release § 88, pp. 180-181).

B. <u>Fraud</u>

The elements of a cause of action for fraud are well-known: representation of a material fact, falsity, scienter, reasonable reliance and injury (*Small v Lorillard Tobacco Co., Inc.*, 94 NY2d 43, 57 [1999]; *Kline v Taukpoint Realty Corp.*, 302 AD2d 433 [2d Dept 2003]). McGuire Children alleges that material information was fraudulently concealed from it. Under these circumstances, Plaintiff must prove that Huntress had a duty to disclose because defendant had a special relationship with Plaintiff or superior knowledge of the facts not available to the other party (*Donovan v Aeolian*, 270 NY 26, 271 [1936]; *Williams v Sidley*

Austin Brown & Wood, LLP, 38 AD3d 219, 220 [1st Dept 2007]; *Dembeck v 220 Cent. Park S., LLC*, 33 AD3d 491, 492 [1st Dept 2006]; *Swersky v Dreyer & Traub*, 219 AD2d 321, 325 [1st Dept 1996]).

Plaintiff has advanced theories of both actual fraud and constructive fraud to urge that the release be declared voidable. Hornbook law in New York recognizes the distinction between "actual fraud" and "constructive fraud" (60A NY Jur 2d, Fraud and Deceit § 2). The former is predicated on an "intentional deception" while the latter generally requires "a confidential fiduciary relationship between the parties, or one party having superior knowledge over the other" (*id.*). The elements for both are the same except that, with constructive fraud, the need to prove knowledge of the falsity of a representation is replaced by the need to establish the existence of a fiduciary/confidential relationship or superior knowledge (*id.*). McGuire Children primarily urges that Huntress engaged in constructive fraud by concealing material facts in breach of his fiduciary duties.

The failure to establish by clear and convincing evidence all of the elements of a fraud cause of action is fatal to that claim (*Chopp v Welbourne & Purdy Agency, Inc.*, 135 AD2d at 959). The critical issue here is whether McGuire Children has established by clear and convincing evidence that it reasonably or justifiably relied on Huntress' silence with respect to the iStar transaction. Establishing reliance is "essential to a claim for fraud" (*Valassis Communications, Inc. v Weimer*, 304 AD2d 448, 449 [1st Dept 2003], *lv denied* 2 NY3d 794 [2004]). To establish reliance sufficient to prevail on a claim for fraud, Plaintiff must show that it acted or refrained from acting based on the alleged misrepresentation or omission (*Premier-*

New York, Inc. v Travelers Property Casualty Corp., 20 Misc 3d 1115(A) [Sup Ct. New York County July 2008]).

The federal courts have attempted to define the test for establishing reliance in a fraud cause of action. "The question of whether a plaintiff's reliance was reasonable typically turns on plaintiff's knowledge, or access to knowledge, at the time the alleged misrepresentations were made; that is, what Plaintiff knew or should have ascertained, given the particular circumstances" (*In re Eugenia VI Venture Holdings, Ltd. Litigation*, 2008 U.S. Dist. LEXIS 101703, *34 [SDNY 2008]). Another United States District Court has held: "[r]eliance is necessary in order to demonstrate causation" (*J.P. Morgan Chase Bank v Winnick*, 350 F Supp2d 393, 405 [SDNY 2004]). In discussing the test of reliance, the court in *J.P. Morgan Chase Bank* held:

> In assessing whether reliance on allegedly fraudulent misrepresentations is reasonable or justifiable, New York takes a contextual view, focusing on the level of sophistication of the parties, the relationship between them, and the information available at the time of the operative decision.

(*J.P. Morgan Chase Bank*, 350 F.Supp2d at 406; *see also Ogunsanya v Langmuir*, 2008 U.S. Dist LEXIS 74376, *13 [EDNY 2008]).

New York courts have long held that, unless facts are peculiarly within a defendant's knowledge, a plaintiff cannot establish reasonable reliance unless it has employed its intelligence and engaged in due diligence. The Court of Appeals has stated:

> [T]he general rule is that if the facts represented are not matters peculiarly within the party's knowledge, and the other party has the means available to him of knowing, by the exercise of ordinary intelligence, the truth or the real quality of the subject of the representation, he must make use of those means, or he will

> not be heard to complain that he was induced to enter into the transaction by misrepresentations (citations omitted)

(*Schumaker v Mather*, 133 NY 590, 596 [1892]).

Both the Appellate Division and trial courts have consistently upheld these principles (*Stuart Lipsky, P.C. v Price*, 215 AD2d 102, 103 [1st Dept 1995] [plaintiffs must use the "means available to ascertain the truth"]; *Ittleson v Lombardi*, 193 AD2d 374, 376 [1st Dept 1993] ["plaintiff was clearly put on notice"]; *Big Apple Consulting USA, Inc. v Belmont Partners, LLC*, 2000 NY Misc. LEXIS 5420, *8 [Sup Ct Nassau County 2008] [justifiable reliance on a misrepresentation cannot be shown when that party could have discovered the truth with due diligence" or "where it could have discovered the true nature of the investments by ordinary intelligence or with reasonable investigation"]; *Premier-New York, Inc.*, 20 Misc 3d 1115(A), *18 [Sup Ct N.Y. County 2008] ["[t]hus, when a party to a transaction has been effectively 'put on notice of the existence of material facts' contrary to the representations of the other contracting party, and then fails to make itself aware of those facts, the party 'may truly be said to have willingly assumed the business risk that facts may not be as represented'"(citation omitted]).

New York courts also have recognized that sophisticated business people have a heightened duty to use the means available to them to verify the truth of the information upon which they rely and to use their sophistication to conduct due diligence. "As a matter of law, a sophisticated plaintiff cannot establish that it entered into an arms length transaction in justifiable reliance on alleged misrepresentations if that plaintiff failed to make use of the means of verification that were available to it" (*UST Private Equity Investors Fund v Salomon Smith Barney*, 288 AD2d 87, 88 [1st Dept 2001]). "To sustain a claim for fraud, sophisticated investors, as here, must have discharged their own affirmative duty to exercise ordinary intelligence and conduct an independent appraisal of the risks they are assuming" (*DDJ Management, LLC v Rhone Group, LLC*, 60 AD3d 421, 424 [1st Dept 2009]).

McGuire Children is controlled by Jim McGuire, a very wealthy and, by his own admission, a highly sophisticated business person. Frank McGuire, the person who established McGuire Children, is likewise a very sophisticated business person.

Huntress' testimony that either Frank McGuire or Jim McGuire told him that they did not care where the money was coming from to buy out the McGuire interests is undisputed. Additionally, Frank McGuire and Jim McGuire both admitted that they never asked Huntress where the money was coming from or what the arrangement was by which Huntress was procuring such a significant amount of money. Frank McGuire admitted that he wondered where the money was coming from but never asked. Neither he, nor Jim McGuire, ever asked about the source of funds even though they continued to have doubts as to Huntress' ability to come up with the money through and until the time of the closing.

The Court concludes that the McGuire interests did not care where the money was coming from because they perceived themselves as being in a far superior position to Huntress. Either they would be paid in full with a very favorable rate of interest, released from all debt obligations and compensated for their attorneys' fees and expenses incurred in closing the buy-out transaction, or they would seize ownership of the most valuable projects possessed by Huntress, assume management control of them, and leave him with the problem projects. This superior situation demonstrates that McGuire Children did not rely upon Huntress' silence but instead relied upon its position of strength in the relationship. They did not care where the money came from because, if it did not show up at the time of closing, they had the ultimate hammer to seize control of whichever projects they desired.

Huntress was in very serious financial jeopardy in 2001 when he sought additional lending from SALC both in May and September. Frank McGuire understood at the time that contractors were threatening to walk off one or more of the projects and that the government was in a position to impose penalties and damages for delay in completing the projects. Frank McGuire testified that he was "concerned" because he knew that Huntress had run out of money. Frank McGuire also acknowledged that, following September 11, 2001, the credit markets and stock markets were likewise in an unfavorable position thereby causing risk and concern for business in general. Huntress even needed help paying his own personal credit cards.

In light of Huntress' financial extremis, even his trusted friend and financier for many years, Frank McGuire, refused to lend Huntress the money he desperately needed. The McGuires only agreed to lend a lesser sum if the McGuire interests acquired ownership of the most favorable projects. Despite the knowledge of Huntress' enormous financial problems and their own refusal to advance the additional monies requested by Huntress, the McGuires never asked a single question about a presumed lender they thought might consider making a "straight loan" (even though M&T Bank had turned Huntress down just a few months earlier). The McGuires' disavowal of any belief that Huntress might have to find an "investor" and sell some or all of the government projects in order to obtain financing to buy out the McGuires is not credible.

The McGuires continued to ignore the obvious questions of who was providing financing and under what terms even after they learned in February of 2002 that the Ezralow deal was dead. Rather, they continued to harbor doubts about Huntress' ability to close the deal knowing all the while that they were ultimately protected by the remedies they had secured in the loan documents.

The facts demonstrate that the McGuire interests neglected to undertake any due diligence to determine Huntress' source of financing despite the clear hints that such financing would undoubtedly be furnished by the new investor on even more favorable terms than the McGuires had obtained. Huntress was in a much worse financial position in late 2001 than he was when SALC agreed to loan $3.4 million to Acquest Development pursuant to the Loan Agreement. It is inconceivable that sophisticated and experienced lenders like Frank and Jim McGuire would not suspect that Huntress would be forced to seek replacement financing on far less favorable terms than the McGuires provided at 12% - 15% interest and 35%-45% equity investments. Moreover, it is evident from Jim McGuire's letters to Huntress, and the precautions he repeatedly undertook during 2001 to protect the McGuires from the risks of being involved with Huntress as partners, that he fundamentally distrusted Huntress. This distrust and Huntress' awful financial problems were nothing short of alarm bells which should have alerted the McGuires that a "straight loan," or even a loan with an "equity kicker," were not what Huntress was attempting to put together.

The courts have recognized that sophisticated investors should use "prophylactic" measures to protect themselves from future events to which they are likely to object (*Global Minerals & Metals Corp. v Holme*, 35 AD3d 93, 100 [1st Dept 2006], *lv denied*

8 NY3d 804 [2007] ["[w]hen a party fails to make further inquiry or insert appropriate language in the agreement for its protection, it has willingly assumed the business risk that the facts may not be as represented"]; *Permasteelisa S.p.A. v Lincolnshire Management, Inc.*, 16 AD3d 352 [1st Dept 2005] ["plaintiff . . . failed to seek the insertion of a prophylactic provision in the purchase agreement to ensure against the possibility of misrepresentation"]; *Curran, Cooney, Penney, Inc. v Young & Koomans, Inc.*, 183 AD2d 742, 743 [2d Dept], *lv denied* 80 NY2d 757 [1992] [despite notice of possible misrepresentations, plaintiff "still proceeded with the transaction without . . . inserting appropriate language into the agreement for his protection" and "willingly assumed the business risk that the facts may not have been as represented"]).

Here, the McGuires did nothing to ensure that they would share in any future benefits Huntress might receive through whatever financing or other arrangements he was making with his investor in order to buy out the McGuires. They were clearly in a position to do so. They were represented by capable counsel. There were numerous documents prepared and exchanged with respect to the buy-out transaction, none of which enabled the McGuire interests to "claw back" any equity or benefits that might inure to Huntress down the road and in which the McGuires now believe they should share.

The McGuires did not ask a single question as to where that financing was coming from even though they had the ultimate hammer over Huntress to ensure that he told them the truth. If Huntress declined to answer or misrepresented the facts to them, they had the means of ascertaining the truth available to them under the agreements they had with Huntress. Upon investigation, the McGuires were in a position of complete strength to seize the projects and displace Huntress if he refused to cooperate. The McGuires' refusal to ask any questions under these circumstances, when they knew full well that any deal for Huntress would be very challenging and as Frank McGuire acknowledged was not an "easy deal," is in this Court's view a complete disregard of a sophisticated business person's obligation to make reasonable inquiries and employ due diligence. Under New York law, sophisticated investors such as the McGuires are required to employ the means available to them. Their failure to do so means that they assumed the business risk of Huntress earning a profit in the future. Therefore, they cannot establish by clear and convincing evidence that they justifiably or reasonably relied on Huntress' silence with respect to the iStar transaction. Accordingly, the fraud cause of action is dismissed.

C. <u>Fiduciary Duty</u>

McGuire Children alleges that Huntress breached the fiduciary duties he owed to it as: (1) a partner or co-venturer; (2) the managing member of the entities that owned the government-sponsored projects; and (3) the majority owner of all of the projects in which the parties were involved. In particular, McGuire Children claims that Huntress breached his fiduciary duties by failing to disclose all information necessary for McGuire Children to make an informed decision about entering into the buy-out transaction. Huntress does not dispute that he owed fiduciary duties to McGuire Children which are akin to the fiduciary duties between partners. Rather, Huntress asserts that any such fiduciary duties came to an end in early October of 2001 when he and Frank McGuire agreed to the essential terms of the buy-out transaction.

The elements of a cause of action for breach of fiduciary duty are: (1) the existence of a fiduciary duty; (2) misconduct of the defendant; and (3) damages that were directly caused by that misconduct (*Kurtzman v Bergstol*, 40 AD3d 588, 590 [2d Dept 2007]). McGuire Children argues that Huntress' fiduciary duties arose from several sources but relies most heavily on the fiduciary duties owed between partners/joint venturers and by managing members of LLCs.

The Court rejects McGuire Children's argument that it and Huntress were engaged in some sort of all-encompassing joint venture. The Court instead adopts the approach taken by Jim McGuire that: "the nature of the relationship from the outset was clearly represented in the documents, . . ." (Ex. E-1). The Court agrees that the documents establish the essential nature of the relationships between the various parties to this action. For example, the relationship between SALC and defendant Acquest Development was one between debtor and creditor as established by the Loan Agreement and the accompanying Term Note and Revolving Note (Exs. 9, 10 and 11). It is well-settled that an ordinary debtor-creditor relationship does not give rise to the existence of a fiduciary duty (*SNS Bank, N.V. v. Citibank, N.A.*, 7 AD3d 352, 354 [1st Dept 2004]; *Marine Midland Bank, N.A. v Yoruk*, 242 AD2d 932, 933 [4th Dept 1997]). The mere fact that the McGuire Children and Huntress had multiple business relationships between them does not elevate an ordinary debtor-creditor relationship to a fiduciary one. The estoppel letter (Ex. E-2) the McGuires insisted Huntress sign underscores this point. For these reasons, the concept that some sort of overriding joint venture relationship existed between McGuire Children and Huntress is rejected because it is contrary to the agreements voluntarily entered into by those parties.

Nevertheless, the agreements the parties entered into include the five (5) operating agreements pertaining to the government projects (Exs. 3-7).[7] The agreements establish that Huntress (along with Eisenbaum) was the managing member of the LLCs as well as a fellow member in the LLCs with McGuire Children. It is well-settled under New York law that managing members of an LLC owe a fiduciary duty to the LLC and to their fellow LLC members (*Out of the Box Promotions, LLC v Koschitzki*, 55 AD3d 575, 578 [2d Dept 2008]; *Nathanson v Nathanson*, 20 AD3d 403, 404 [2d Dept 2005]; *Lio v Zhong*, 21 Misc3d 1107[A] [Sup Ct NY County 2008]; *In re Dil Eliedermans, LLC*, 325 BR 101 [B Ct SDNY 2005]). The courts also have held that members of an LLC owe fiduciary duties to each other essentially on the theory that they are akin to partners (*Willoughby Rehab. and Health Care Ctr, LLC v Webster*, 13 Misc3d 1230 (A) [Sup Ct NY County 2006], *order aff'd* 46 AD3d 801 [2d Dept 2007 ["(a) limited liability company is (a) hybrid business entity having attributes of both a corporation and a partnership . . .. The acts of working in concert and managing a limited liability company clearly give[ ] rise to a relationship among members which is analogous to that of partners "]; *see also Berman v Sugo, LLC*, 580 F Supp2d 191, 204 [SDNY 2008]; *Kim v Ferdinand Capital LLC*, 2007 NY Misc LEXIS 5431 [Sup Ct NY County 2007]). Managing members, however, like managing partners, have a heightened duty to their fellow LLC members (*Birnbaum v Birnbaum*, 73 NY2d 461, 466 [1989], *rearg denied*, 74 NY2d 843

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As noted above, the operating agreement for Lincoln Park is not in the record. It also is this Court's understanding of Plaintiff's arguments that Plaintiff is not seeking relief with respect to that project as it was not part of the undisclosed iStar transaction resulting in the purchase of three (3) of the government projects.

[1989]; *Auld v Estridge*, 86 Misc2d 895, 902 [Sup Ct Nassau County 1976], *aff'd* 58 AD2d 636 [2d Dept], *lv denied* 43 NY2d 641 [1977]; *Meinhard v Salmon*, 249 NY 458, 468 [1928]).

The fiduciary duties Huntress assumed by serving as managing member of the five (5) LLCs include most pertinently the obligation to make full disclosure of all material facts involving the LLCs (*Albert v 28 Williams St. Corp.*, 63 NY2d 557, 569 [1984], *rearg. denied* 64 NY2d 1041 [1985]; *Meinard v Salmon*, *supra; Lio v Zhang, supra; Ajettix, Inc. v Raub*, 9 Misc3d 908, 913 [Sup Ct Monroe County 2005]). Huntress also owed McGuire Children a "duty of undivided and undiluted loyalty" requiring him to "single-mindedly pursue the interests" of McGuire Children, the fellow LLC member to whom this duty of loyalty was owed (*Birnbaum*, 73 NY2d at 466).

Huntress' fiduciary duties to McGuire Children do not arise out of the language of the operating agreements but out of the relationship he voluntarily entered into by agreeing to become a member in an LLCs and their managing member (*Anderson v Weinroth*, 48 AD3d 121, 136 [1st Dept 2007]; *Charles v Onondaga Community College*, 69 AD2d 144, 146 [4th Dept], *appeal dismissed* 48 NY2d 650 [1979], *citing Albermarle Theater, Inc. v Bayberry Realty Corp.*, 27 AD2d 172 [1st Dept 1967]). Unlike the "business judgment rule" codified in Limited Liability Company Law ("LLCL") § 409(a)[8] and Business Corporation Law ("BCL") § 717 which typically generates derivative causes of action by members and shareholders against managing members and directors, respectively (*see generally Tzolis v Wolff*, 10 NY3d 100 [2008]; 16 NY Jur. Business Relationships § 2107 [2008]; 1-6 NY Practice Guide:

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[8] The language from LLCL § 409(a) is incorporated into each of the operating agreements governing the government-sponsored projects in section 4.2.

Business and Commercial § 6.13 [2008]; 2-7 White, New York Business Entities P B717.01 [2009]), the fiduciary duties owed by partners and LLC members are owed directly to one another and ordinarily cause harm first to the fellow partner or LLC member (*see generally Billings v Bridgepoint Partners, LLC*, 21 Misc3d 535, 539 [Sup Ct Erie County 2008]; *Willoughby Rehab and Health Care Centers, supra*). Here, the alleged harm to McGuire Children is based primarily on Huntress' breach of his duties to make full disclosure and devote undivided loyalty to the McGuire Children's interest as opposed to a breach of the statutory duty (LLCL § 409[a]) and contractual duty (contained in section 4.2 of each operating agreement) to exercise proper business judgment. It is this direct common law fiduciary duty which underlies all of McGuire Children's causes of action in this litigation.

Huntress has not debated either the existence or nature of his fiduciary duties to McGuire Children. Instead, the critical issue for Huntress is his assertion that any fiduciary duties he owed to McGuire Children terminated in early October of 2001 when Huntress and Frank McGuire agreed to the essential terms of the buy-out transaction. In support of this assertion, Huntress relies primarily on two cases determining that principal/agent fiduciary duties terminate upon a definitive act by the parties (*Dubbs v Stribling & Assocs.*, 96 NY2d 337 [2001]; *Midcourt Bldrs. Corp. v Eagen*, 36 AD2d 90 [4th Dept 1971], *aff'd* 31 NY2d 728 [1972]). Huntress also relies on cases involving the dissolution of various types of partnerships holding that the fiduciary relationship between partners terminates upon notice of dissolution (*Morris v Crawford*, 304 AD2d 1018 [3d Dept 2003]; *Wynne v Gruber*, 237 AD2d 284 [2d Dept 1997]; *Matter of Silverberg [Schwartz]*, 81 AD2d 640 [2d Dept 1981]; *Bayer v Bayer*, 215 AD 454 [1st Dept 1926]).

The cases relied upon by Huntress are distinguishable in a number of ways. In *Midcourt Builders*, the principal clearly and lawfully terminated the agency. In *Dubbs*, the parties supplanted their fiduciary relationship with an arms' length one through a written agreement. Here, there was no enforceable or definitive termination of the relationship between Huntress and McGuire Children until the actual closing in March of 2002. Until the closing, both parties retained significant doubt about whether Huntress could accomplish it. McGuire Children also never surrendered its rights as an LLC member until the withdrawal transaction actually closed. In fact, the record confirms that neither Huntress nor McGuire Children altered their behavior toward one another after the deal was allegedly struck between Huntress and Frank McGuire in October of 2001. Huntress continued to serve as the managing member of the LLCs and McGuire Children continued its involvement as a member. Nothing changed between the parties until the closing in March of 2002.

The partnership dissolution cases relied upon by Huntress also are distinguishable because, while LLCs are a hybrid of a corporation and a partnership, they are not partnerships as a matter of law. Partnerships may be dissolved merely by the will of any partner and the courts have recognized that an event of dissolution may cause a "relaxation" of fiduciary duties before the partnership is wound up (Partnership Law § 62; 15A NY Jur. 2d, Business Relationships §§ 1612-1613, 1830 [2009]). The same is not true for LLCs. Pursuant to LLCL Article VI, members may withdraw from membership only as specified in the operating agreement or after the LLC has been wound up (LLCL § 606). Membership interests also may be assigned (LLCL § 603). These sections make clear that LLC membership interests, for purposes of withdrawal, are not the same as partnership interests. In fact, the parties here strictly followed the LLCL by entering into at closing a "Withdrawal of Membership Interests Agreement" for each of the six (6) LLCs in which they were still members (Ex. 46).

Huntress has therefore failed to establish that his fiduciary duties as an LLC member and as the LLCs' managing member ceased when the essential terms of the buy-out transaction were orally agreed upon in October of 2001. Rather, the Court concludes that Huntress' fiduciary duties did not as a factual matter or as a matter of law terminate until the closing date in March of 2002 (*see e.g. Madison Hudson Assocs., LLC v Neumann*, 44 AD3d 472, 483 [1st Dept 2007]; *Blue Chip Emerald LLC v Allied Partners*, 299 AD2d 278, 279 [1st Dept 2002];).

Huntress repeatedly testified at trial that he disclosed all important information involving the government-sponsored projects to the McGuire interests except for the iStar transaction. The Court concludes based on Huntress' testimony that he specifically withheld this information from his fellow member, i.e. McGuire Children. In this way, Huntress breached his duty of undivided loyalty and his duty to make full disclose to his fellow LLC member.

Huntress further argues that the McGuire interests had no interest in the iStar transaction because they told him they did not care where he got the money "to pay them off." Huntress is thereby arguing that McGuire Children failed to rely upon his fiduciary duties and/or that the information pertaining to the iStar transaction was immaterial. The Court rejects both of these arguments. First, unlike a cause of action for fraud, reliance is not an element of a cause of action for breach of fiduciary duty. Rather, the courts have routinely held that a person to whom a fiduciary duty is owed need not conduct his or her own independent investigation

(*Anderson v Weinroth*, 48 AD3d 121, 136 [1st Dept 2007]; *TPL Assoc. v Helmsley Spear, Inc.*, 146 AD2d 468, 471 [1st Dept 1989]; *Slayback v Raymond*, 93 AD 326, 333 [1st Dept 1904]).[9] Second, there is no doubt that the information pertaining to the iStar transaction was material because it involved a prospective sale of one or more of the government-sponsored projects. Moreover, Huntress kept the McGuire interests abreast of everything that was occurring with respect to those projects, including a prospective sale to Ezralow. Huntress also told Eisenbaum about iStar. Thus, by his own actions, Huntress has demonstrated the materiality of a prospective sale of one or more of the projects to a large national REIT.

Based on the foregoing, the Court concludes that Huntress owed fiduciary duties to McGuire Children and that, through his misconduct in failing to disclose the iStar transaction to McGuire Children, he violated those duties. However, to achieve success on its breach of fiduciary duty claim and thereby render the General Release voidable, McGuire Children also must prove by clear and convincing evidence the "essential element" of damages which were proximately caused by Huntress' misconduct (*Great Am. Ins. Co. v Canandaigua Nat'l Bank & Trust Co.*, 45 AD3d 1299, 1300 [4th Dept 2007], *lv denied* 10 NY3d 703 [2008]; *R.M. Newell Co., Inc. v Rice*, 236 AD2d 843, 844 [4th Dept], *lv denied* 90 NY2d 807 [1997]; *Laub v Faessel*, 297 AD2d 28, 30-31 [1st Dept 2002]; *Donovan v Ficus Investment*, 20 Misc3d 1139 [A] *14 [Sup Ct New York County 2008]). McGuire Children must now proceed to the

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Huntress relies on language in *Littman v Magee* (54 AD3d 14 [1st Dept 2008]), to argue that reliance is an element of a cause of action for breach of fiduciary duty. The Court concludes that the language in *Littman* is addressing a fraud cause of action premised on non-disclosure as opposed to breach of fiduciary duty. In any event, the greater weight of Appellate Division authority does not establish that reliance is an element of a breach of fiduciary duty claim.

remedies portion of the trial to establish by clear and convincing evidence that it suffered damages proximately caused by Huntress' failure to disclose the iStar transaction.

D. Breach of Contract and Breach of Implied Covenant of Good Faith and Fair Dealing

Plaintiff alleges in its first and second causes of action theories premised on breach of contract and breach of the implied covenant of good faith and fair dealing.[10] Plaintiff alleges that a purported "Joint Venture Agreement" and the five (5) operating agreements pertaining to the government-sponsored projects were all breached by defendants. As noted above, the Court has concluded that there was no overriding joint venture arrangement between McGuire Children and any of the defendants. Accordingly, any claim that there is a "Joint Venture Agreement" is rejected as without merit.

With respect to the operating agreements pertaining to the government-sponsored projects, McGuire Children alleges that there was a "contractual fiduciary duty which was breached by Huntress by failing to disclose the iStar agreement and the iStar transaction" (Plaintiff Post-Trial Memorandum of Law, p. 28). In this regard, it appears that McGuire Children is relying upon Section 4.2 of each operating agreement. The Court has concluded above that this section of the operating agreements sets forth the "business judgment rule." Plaintiff has made no argument that this rule was violated but rather that Huntress breached his fiduciary duties of undivided loyalty and full disclosure by withholding the information concerning the iStar transaction. Plaintiff has therefore failed to establish any breach of the business judgment rule and any claim to that effect is therefore denied.

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[10] These two causes of action were reinstated pursuant to the plaintiff's motion for reargument.

Furthermore, in this context, it is clear that McGuire Children seeks to allege that the operating agreements were breached by virtue of Huntress' breach of his fiduciary duties. Because this Court has concluded that those duties arose out of the status of Huntress as the managing member of the LLCs and as a fellow member of the LLCs with McGuire Children, and not out of the language of the operating agreements, the duty purportedly breached is not one which arises under contract law but rather independent of the contract. Plaintiff's claim for breach of contract based on the failure to disclose the iStar transaction is therefore dismissed.

McGuire Children also alleges that there was a breach of the super-majority requirement in the operating agreements pertaining to the prohibition against self-dealing. This too is nothing more than a duplication of the breach of fiduciary duty claim. Moreover, once McGuire Children disposed of its membership interest in the LLCs, it lost its standing to assert a breach of those provisions of the contract. For all of these reasons, the breach of contract cause of action is in all respects dismissed.

The second cause of action alleging breach of the implied covenant of good faith and fair dealing is duplicative of the breach of contract cause of action and of the breach of fiduciary duties cause of action. Because a breach of implied covenant cause of action cannot survive under these circumstances, it also is dismissed (*Jacobs Private Equity, LLC v 450 Park LLC*, 22 AD3d 347 [1st Dept 2005], *lv denied* 6 NY3d 703 [2006]; *Triton Partners, LLC v Prudential Securities, Inc.*, 307 AD2d 411 [1st Dept 2003]).

E. Misappropriation of Corporate Opportunity and Negligent Misrepresentation

McGuire Children have sought to assert causes of action for misappropriation of a corporate/business opportunity and/or self-dealing and for negligent misrepresentation.[11] Under New York law, a cause of action for conversion of a corporate opportunity is derivative in nature and does not belong to an individual shareholder (*Glenn v Hoteltron Sys., Inc.*, 74 NY2d 386, 390 [1989]; *Rosenthal v Parmett*, 161 AD2d 693 [2d Dept 1990]). Plaintiff has not sought to assert a derivative cause of action but rather articulates a cause of action premised solely on its own individual harm rather than harm to the LLC. Under the circumstances presented here, it is the LLC which is harmed first by the alleged conversion of a corporate opportunity and, therefore, Plaintiff has failed to properly assert a cause of action for derivative relief (*Marx v Akers*, 88 NY2d 189, 193 [1996]; *Isaac v Marcus*, 258 NY 257, 264 [1932]). Further, because McGuire Children is no longer a member of any of the LLCs involved in this action, it lacks standing to assert any such derivative causes of action (*Billings v Bridgepoint Partners, LLC*, 21 Misc3d 535, 541 [Sup Ct Erie County 2008]). To the extent that Plaintiff alleges "self-dealing" in the eighth cause of action, the Court concludes that these allegations are redundant of Plaintiff's allegations that Huntress breached his fiduciary duty as addressed above. For all of these reasons, the eighth cause of action is in all respects dismissed.

With respect to the ninth cause of action alleging negligent misrepresentation, among the elements of that cause of action which Plaintiff must establish is reliance (*Credit*

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11 Plaintiff's motion to amend its Amended Complaint to conform to the proof at trial has been granted and Plaintiff has clarified its theory of recovery alleged in the eighth cause of action.

Alliance Corp. v Arthur Andersen & Co., 65 NY2d 536, 551 [1985]; *Ford v Sivilli*, 2 AD3d 773, 774 [2d Dept 2003]). As discussed above, Plaintiff has failed to establish the element of reliance for the fraud cause of action and for the same reasons the Court concludes that Plaintiff has failed to establish the reliance element for a cause of action based on negligent misrepresentation. Accordingly, the ninth cause of action is likewise dismissed.

The Court will conduct a final pretrial conference on **Monday, June 29, 2009 at 10:00 a.m.** for the purposes of scheduling the next phase of the trial.

Settle Order.

DATED: June 17, 2009

HON. JOHN M. CURRAN, J.S.C.