

Baltic Fourth LLC v Stern
2021 NY Slip Op 31230(U)
April 9, 2021
Supreme Court, New York County
Docket Number: 654881/2018
Judge: Barry Ostrager
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**SUPREME COURT OF THE STATE OF NEW YORK
NEW YORK COUNTY**

PRESENT: HON. BARRY R. OSTRAGER. PART IAS MOTION 61EFM

Justice

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BALTIC FOURTH LLC, directly and derivatively on behalf of
FOURTH AVENUE JV LLC, FOURTH AVENUE MEZZ LLC, and
FOURTH AVENUE PROPERTY OWNER LLC, and TONA
CONSTRUCTION & MANAGEMENT LLC,

Plaintiffs,

- v -

MICHAEL STERN, JDS FOURTH AVENUE LLC, and JDS
CONSTRUCTION GROUP LLC,

Defendants.

FOURTH AVENUE JV LLC, FOURTH AVENUE MEZZ LLC, and
FOURTH AVENUE PROPERTY OWNER LLC

Nominal Defendants.

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INDEX NO. 654881/2018

**DECISION & ORDER
ON MOTIONS 009 and 010**

OSTRAGER, J.

This dispute arises out of a joint venture between Baltic Fourth LLC and JDS Fourth Avenue LLC for the development of property in Brooklyn, New York (“the Property”). In December 2013 Baltic Fourth LLC and JDS Fourth Avenue LLC formed a joint venture company called Fourth Avenue JV, LLC (“the Company”), a Delaware LLC. The Company then formed Fourth Avenue Property Owner LLC (“Owner”), a Delaware LLC, to hold title to the Property. In April 2014, Domenick Tonacchio, principal of Baltic Fourth, LLC, and Michael Stern, principal of JDS Fourth Avenue LLC (“Manager”), executed an Amended and Restated Limited Liability Agreement of Fourth Avenue JV, LLC (“the JV Agreement”) on behalf of their respective companies. The Agreement governs the parties’ relationship with respect to

developing the Property. In April 2016, Owner and JDS Construction Group LLC entered a Construction Management Agreement.

Before the Court is Motion 009 by Defendants for summary judgment in their favor on all of Plaintiffs' remaining causes of action and Motion 010 by Plaintiffs for partial summary judgment in their favor on Count One for a Declaratory Judgment and for Breach of the Joint Venture Agreement. The Court heard oral argument on both motions via Microsoft Teams on April 7, 2021. On the record of April 7, 2021, the Court granted Motion 010 in part and reserved decision on Motion 009.

Motion 010

Turning first to Motion 010, Plaintiffs' motion for summary judgment on Count One for a Declaratory Judgment is granted to the following extent: Distributable Funds, if any, shall be distributed to the Members quarterly or more frequently from time to time as determined by [JDS Fourth]. Such Distributable Funds shall be distributed in the following order and priority: (i) First, Fourteen Million and 00/100 Dollars (\$14,000,000.00) to Tonacchio; (ii) Second, Five Million and 00/100 Dollars (\$5,000,000.00) to [JDS Fourth]; and (iii) Thereafter, one hundred percent (100%) to the Members in proportion to their respective Percentage Interests at the time of such distribution. *See* JV Agreement Section 5.2. Indeed, this the exact language of Section 5.2 and there is no dispute as to its meaning.

The Court rejects Defendants' argument that the claim for a Declaratory Judgment is not yet ripe. The claim is for an adjudication of legal rights, regardless of whether there are actually Distributable Funds available to be paid. Indeed, Plaintiffs have cited evidence that there are Distributable Funds available. However, the Court makes no determination at this time whether there are any remaining Distributable Funds, and if so in what amount. This is an issue of fact

that must be proven at trial. Additionally, the Court makes no finding at this time regarding how much of the First Fourteen Million has already been paid, as there is a dispute about whether certain payments made by Defendants offset the total amount owed under the waterfall provision. This too is an issue that must be proven at trial.

Plaintiffs also moved for summary judgment for breach of the Joint Venture Agreement on several grounds. Plaintiffs assert that (1) Defendants have failed to distribute existing Distributable Funds and (2) Defendants have depleted the Distributable Funds through a series of improper payments. Plaintiffs categorize the improper payments as (1) improper payment of legal fees, (2) overpayment of a member loan, and (3) a payment for a different JDS project.

On the record of April 7, 2021, the Court granted summary judgment in Plaintiffs' favor as to the improper legal fees only, a decision which the Court has reconsidered, as set forth *infra*.

There are three sections in the JV Agreement that address attorney's fees. Under Section 12.11 of the JV Agreement, the parties agreed "[i]n the event of any dispute between the parties hereto, the prevailing party shall be entitled to recover from the other party reasonable attorney's fees and costs incurred in connection therewith."

Section 8.3(b) provides that "[t]he Company (or applicable Subsidiary) will from time to time reimburse Manager for its reasonable out-of-pocket expenditures incurred in connection with the performance of its duties hereunder, including all third-party asset-specific and administrative costs such as legal, accounting, appraisal, environmental and structural review. All reimbursement of expenses pursuant to this Section 8.3(b) will be subject to inclusion in a Budget and, subject to Section 8.8, will not include any expenses representing payroll or overhead costs of Manager or of any Affiliate of Manager."

Section 8.7(a) provides that “[t]o the fullest extent permitted by applicable law, Manager and any Manager's Affiliated Person is hereby indemnified by the Company for any loss, damage or claim by reason of any act or omission performed or omitted by it on behalf of the Company and in good faith and in a manner reasonably believed to be within the scope of the authority conferred on it by this Agreement, except that, without limitation, Manager and Manager's Affiliated Person shall not be entitled to be indemnified in respect of any loss, damage or claim incurred by it by reason of Manager's or an Affiliate of Manager's gross negligence, criminal acts, willful misconduct, or in respect of any loss, damage or claim resulting from a material breach by Manager or an Affiliate of Manager of any provision or representation and warranty contained in this Agreement or any other agreement of Manager or an Affiliate of Manager with the Company or a Subsidiary, fraud, or the bankruptcy or insolvency of Manager or any of its Affiliates which is a Member; provided, however, that any indemnity under this Section 8.7 shall be provided out of and to the extent of Assets only, and no Member shall have personal liability on account thereof.”

Defendants argue that all of these provisions contemplate the payment of JDS' expenses—including legal fees—incurred from its conduct as Manager. Plaintiffs argue that Section 8.3 (b) refers to reimbursement for incidental legal costs incurred in performing legitimate duties as manager and does not apply to a situation such as here where another member has sued JDS for fraud, breach of fiduciary duty and breach of contract. With respect to Section 8.7 (a), Plaintiffs argue that the parties did not intend to indemnify JDS Fourth (or Stern or JDS Construction) for claims relating to breach of the JV Agreement, or any related agreement, or for criminal or willful misconduct, including fraud, which is precisely what is at issue in this action.

Given that disputes between members are separately addressed in Section 12.11, Plaintiffs' reading of the JV Agreement is most logical, that there was no intent to reimburse JDS's legal fees for a dispute among members. As far as whether JDS can properly be indemnified for the costs of this litigation, that may depend on whether Plaintiffs prove at trial that there has been gross negligence, criminal acts, or willful misconduct. This is a case in which it is alleged that documents material to the outcome of this case were forged by the individual defendant. Accordingly, while the Court was – as is – inclined to find Plaintiffs' argument with respect to the attorney's fees issue meritorious, the Court revisits and withdraws its prior ruling and finds that there are issues of fact that must be proven at trial, including but not limited to the actual amount of legal fees that were paid with Project funds on behalf of which Defendants those fees were paid. (It came to light at oral argument that this number is disputed, and presumably, growing).

Accordingly, motion 010 is granted to the extent set forth above and all other issues are reserved for trial.

Motion 009

Turning next to Motion 009, Defendants move to dismiss all of Plaintiffs' remaining causes of action. This motion is denied in its entirety.

Defendants first argue that all causes of action against Michael Stern and JDS construction should be dismissed because they are not alter egos of JDS Fourth. This is a question of fact to be proven at trial. Plaintiffs have put forth sufficient evidence to overcome a motion for summary judgment on the alter ego issue.

Next, Defendants argue that Defendants are entitled to summary judgment of plaintiffs' claims for breach of the Joint Venture Agreement. Plaintiffs' claims for breach of the Joint

Venture Agreement are premised on alleged (1) improper payments of Project Funds. (2) failure to select Tona as Project Manager, and (3) failure to provide books and records.

First, there are issues of fact regarding whether Defendants took any improper distributions from the Project. Plaintiffs and Defendants both cite to the ledger of Project costs and payments, created at the Court's direction, in support of their arguments that certain payments were and or were not proper. This issue is a question of mixed and law and fact that the Court cannot determine without the aid of trial testimony.

Second, Defendants argue the selection of JDS Construction as the Construction Manager did not violate the JV Agreement. The selection of the Construction Manager is governed by Section 8.9 of the JV Agreement, which states:

The parties hereto acknowledge that, subject to the approval of the lender under the Construction Loan, Tona Construction & Management LLC, an Affiliate of Tonacchio ("Tona") shall be the initial construction manager with respect to the development of the Properties and shall be paid a construction management fee equal to three percent (3%) of the hard costs in accordance with the terms of a construction management agreement (the "Construction Manager Agreement"), by and between Tona on the one hand, and Property Owner, on the other hand, which shall be entered into on the closing of the Construction Loan. The parties hereto acknowledge that the terms of the Construction Management Agreement shall be enforceable by Manager and that Manager shall be permitted to terminate Tona as the construction manager under the Construction Management Agreement for any reason or no reason. For the avoidance of doubt, Tona shall not be the construction manager, and the Construction Management Agreement shall not be entered into or effective, during the pendency of the Acquisition Loan.

It is undisputed that Tona never received the requisite lender approval, thereby precluding its ability to serve as the Construction Manager. However, Plaintiffs have raised two materials issues: first, whether the choice of lender was reasonable, or whether defendants purposefully chose a lender that would reject Tona as Construction Manager (Plaintiffs cite evidence of a commitment from another lender with lower interest rates); and second, whether, if

Tona was not approved, Defendants were or were not permitted to select JDS as Construction Manager without Baltic's approval. The JV Agreement does not state on its face how the Construction Manager should be selected in the event Tona was not approved. Accordingly, Plaintiffs have put forth sufficient evidence and raised sufficient issues of material fact to proceed to trial on their claims for breach of the JV Agreement.

Defendants argue that Defendants are entitled to summary judgment on Plaintiffs' claim for Breach of the Construction Manager Agreement ("CMA"). Baltic asserts a derivative claim against JDS Construction and Stern on behalf of Owner for breach of the CMA based on their alleged failure to enter into a guaranteed maximum price ("GMP") for the Project, implement the Project in an "efficient" manner, and maintain books and records. (FAC ¶¶ 482-507 [Count X].)

Defendants argue that they did in fact enter at GMP and complete the project under the amount of the GMP. On November 1, 2016, JDS Construction and Owner executed an amendment to the CMA, which set the GMP at \$34,826,609.83. This GMP reflected approximately \$1.5 million in savings relative to the original project budget of \$36.3 million. G4 and an independent construction consultant—Project Control Associates ("PCA") both reviewed and approved the GMP.

In opposition, Plaintiffs first argue that the CMA is void and unenforceable because it was entered into as part of an ongoing fraud and without authority. Plaintiff also argue, alternatively, that if the CMA is found to be valid, Defendants have breached it because JDS Construction failed to require trade contractors to fully and properly perform their contract scope, including punch list and remedial work. Plaintiffs argue that JDS Construction mismanaged the Project, closing out trade contracts before work was complete and accepted and then, when remaining items or remedial work were necessary, failing to require those trade

contractors to return to perform it. Plaintiffs argue that JDS Construction hired new contractors, paying them hundreds of thousands of dollars and transferring this cost onto the Property Owner.

Defendants' argument that the Project was properly managed because it was completed within the GMP may very well be evidence that the Project was properly managed, but it is insufficient on this motion for summary judgment to find in Defendants' favor as a matter of law that there was no breach of the CMA. There are issues of fact to be resolved at trial regarding the circumstances surrounding the execution of the CMA and its validity, as well as whether the Project was properly managed.

Defendants also argue that there was no breach of the CMA because Defendants did maintain proper books and records consistent with Section 18.1.1 of the CMA which required that JDS Construction "maintain a daily log of all on-Site operations, invoices and requisitions." Defendants cite to the deposition of Frank Tonacchio, in which he admitted that JDS Construction maintained such a log of on-site operations—and that he received it.

In opposition, Plaintiffs argue specifically that JDS Construction failed to meet its obligation with respect to invoices by submitting only one-page invoices to support millions of dollars in payments, including for payroll. Plaintiffs argue that these documents do not constitute commercially reasonable invoices. Plaintiffs further argue the labor invoices submitted were knowingly false and were not based on actual labor hours, but on "projections" made before the labor was provided. The validity and sufficiency of the invoices are issues of fact to be proven at trial.

Finally, Defendants argue that there can be no personal liability against Mr. Stern for breach of the CMA because Section 20.8 of the CMA provides that "no personal liability shall arise out of this Agreement . . . absent criminal or wanton conduct." In opposition, Plaintiffs

argue that Mr. Stern's conduct falls squarely within the carve out for criminal and wanton conduct, including fraud in pursuit and management of the CMA. This is a mixed issue of law and fact to be determined at trial and therefore summary judgment is denied on this point.

Next, Defendants argue that Defendants are entitled to summary judgment on Plaintiffs' fraud claims. Baltic asserts a derivative claim on behalf of Owner against Defendants for allegedly submitting fraudulent payroll invoices for payment, and a direct claim against JDS and Stern for allegedly forging the Side Letter and Written Consent. (FAC ¶¶ 456-481, 546-563 [Counts IX & XIV].) Defendants first argue that Plaintiffs' fraud claims are duplicative of the claim for breach of the CMA. The Court rejects this argument to the extent that Plaintiffs are advancing alternative theories.

Defendants argue that there is no evidence the payroll invoices are inaccurate or fraudulent. In opposition, Plaintiffs argue that the invoices (1) were conclusory in nature, (2) were for far more than the budgeted amount, (3) included work outside the responsibilities of JDS Construction, and (4) were based on predetermined allocations, on a project-by-project basis, that went unchanged for months. Plaintiff contends that Defendants would allocate the time of *all* JDS Construction employees, including their home office employees, among JDS Construction's ongoing projects, without regard to whether the time was actually spent on those projects. The sufficiency and accuracy of the invoices are questions of fact to be determined at trial.

With respect to Plaintiffs' direct claim against JDS Construction and Stern for allegedly forging the Side Letter and Written Consent, Defendants argue that Plaintiffs have failed to show reliance and damages. In opposition, Plaintiffs argue Baltic was not aware of the forgery until it received copies of the forged documents through discovery in this action and Tonacchio was able

to see, for the first time, that the documents had been forged on his behalf. Had Baltic been aware of the forgery, it could have taken steps to protect its rights, namely it could have exercised its Buy/Sell rights under the JV Agreement, rights that were, not coincidentally, waived in the forged documents. Plaintiffs argue that under the Buy/Sell provisions of the JV Agreement, Baltic could have required Defendants to buy Baltic out of the Project or to sell their own interest to Baltic. Baltic argues that this right is incredibly valuable and could have allowed Baltic to receive substantial profits without delay or the need for litigation, and Baltic was unable to exercise the right because it relied on the belief that Tonacchio's name had not been forged. Similarly, Baltic relied on the belief that no forgery had occurred in assuming JDS Construction had not been formally retained under a construction management agreement without Baltic's consent.

The Court finds that Plaintiff need not establish reliance in the case of a forged signature. Indeed, Courts have found that there "is no requirement in a [forgery case] that a claim based on forgery must allege that plaintiff justifiably relied on a defendant's misrepresentation" *Shelley v. Mintz, Levin, Cohn, Ferris, Glovsky & Popeo, P.C.*, 24 Misc. 3d 1223(A), 899 N.Y.S.2d 63 (Sup. Ct. 2009) *citing Piedra v Vanover*, 174 AD2d 191, 194 (2d Dept 1992). In *Shelley*, the Court reasoned that "the absence of any requirement to show justifiable reliance is apparent, because in a forgery case, particularly where a defendant allegedly forged plaintiff's signature on a document, any reliance by a plaintiff on the forged signature would be inapposite and counterintuitive" *citing Parrish v Unidisc Music, Inc.* (1 Misc 3d 1122[A], 2008 NY Slip Op 52152 [U] [Sup Ct, NY County 2008]). Plaintiffs have also sufficiently demonstrated damages to proceed to trial on their fraud claims.

Defendants also argue that Defendants are entitled to summary judgement on Plaintiffs' claims for breach of fiduciary duty. Through Counts VIII and XII, Baltic asserts direct and derivative claims for breach of fiduciary duty against Defendants for the alleged forgery of the Side Letter and Written Consent (FAC ¶¶ 429, 437), the selection of JDS Construction as the Construction Manager (id. ¶¶ 433- 434), the alleged inflation of the Project's costs and payroll expenses (id. ¶ 440, 535-36), and the purported waste of corporate assets by selecting lenders with above-market interest rates (id. ¶ 445). Defendants argue that Plaintiffs have failed to demonstrate the existence of a fiduciary relationship, the existence of the alleged breaches, or damages.

To the first point, Defendants argue that fiduciary duties were waived pursuant Section 8.5 of the JV Agreement which provides that "none of the Members shall have duties or liability to . . . any other Member (including fiduciary duties)" except for "actions or omissions that involve fraud, intentional misconduct or a knowing and culpable violation of law" and "transaction[s] not permitted . . . under . . . this Agreement from which such party derived a personal benefit." In opposition, Plaintiffs argue that Mr. Stern's alleged conduct is exactly the "intentional misconduct" that was carved out from the waiver. Accordingly, this section does not bar Plaintiffs' fiduciary duty claims.

With respect to the alleged breach, Defendants argue that, again, Tona was unable to be selected as Construction Manager because the Lender declined, and there is no evidence that Defendants fraudulently inflated the Project's costs or forged the Written Consent or Side Letter. As explained above, there are material issues of fact with respect to each of these issues that must be proven at trial.

Finally, Defendants argue that Defendants are entitled to summary judgment on Baltic’s accounting claim because Baltic has not established a fiduciary relationship. As explained above, Baltic has sufficiently shown the existence of a fiduciary relationship to survive a motion for summary judgement and this claim will proceed to trial.

Accordingly, motion 009 is denied in its entirety and these issues will proceed to trial.

Trial

The trial of this action is scheduled for June 2, 2021. As discussed on the record of April 7, 2021, the parties are directed to efile memoranda of law by April 16, 2021 addressing the structure of the trial insofar as which issues would need to be tried by a jury and the order of issues presented. The parties are also strongly encouraged to attempt to mediate this case. A pretrial conference is scheduled for May 19, 2021 at noon via Microsoft Teams.

Dated: April 9, 2021


BARRY R. OSTRAGER, J.S.C.

CHECK ONE:

APPLICATION:

CHECK IF APPROPRIATE:

<input type="checkbox"/>	CASE DISPOSED	<input type="checkbox"/>	DENIED	<input checked="" type="checkbox"/>	NON-FINAL DISPOSITION	<input type="checkbox"/>	OTHER
<input type="checkbox"/>	GRANTED	<input type="checkbox"/>		<input checked="" type="checkbox"/>	GRANTED IN PART	<input type="checkbox"/>	
<input type="checkbox"/>	SETTLE ORDER	<input type="checkbox"/>		<input type="checkbox"/>	SUBMIT ORDER	<input type="checkbox"/>	
<input type="checkbox"/>	INCLUDES TRANSFER/REASSIGN	<input type="checkbox"/>		<input type="checkbox"/>	FIDUCIARY APPOINTMENT	<input type="checkbox"/>	REFERENCE