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LAW CURRENTS An informational newsletter from
Richard A. Klass, Esq.

I would do anything for [my partners] but I won't do that

Two partners owned vacant lots in Manhattan and wanted to build on them. They found two developers who pitched building townhouses on the lots. The four of them entered into a joint venture agreement ("JVA").[1] Essentially, the agreement was that, in return for the developers paying off debts owed on the lots, refinancing an existing mortgage and obtaining a new construction loan, the lot owners would transfer the property to a limited liability company ("LLC") to be jointly owned by all four of them.

Joint Venture Agreement

According to the JVA, ownership of the new LLC would be equally divided among the four partners (25% each). The LLC was supposed to refinance the property. The funds from the refinance would first be utilized to satisfy the existing mortgage on the property and then finance all of the construction costs for three single-family townhouses. The developers were to use their best efforts to obtain a construction loan to perform the purpose of the joint venture, and the lot owners were to fully cooperate in these efforts.

Formation of the LLC

One of the developers formed an LLC into which title to the lots would be transferred. The LLC was initially formed with him as the sole member for convenience purposes until the prospective refinance and closing were to take place, at which time all four partners would constitute the members.

Lack of cooperation

In order to comply with the mortgage lender's requests about the property, the developers needed certain back-up documentation from the lot owners concerning expenses. The lot owners did not provide the

[1] Under New York law, five elements are necessary to form a joint venture: "(1) two or more persons must enter into a specific agreement to carry on an enterprise for profit; (2) their agreement must evidence their intent to be joint venturers; (3) each must make a contribution of property, financing, skill, knowledge or effort; (4) each must have some degree of joint control over the venture; and (5) there must be a provision for the sharing of both profits and losses." *Dinaco, Inc. v. Time Warner Inc*., 346 F.3d 64, 67-68 (2d Cir. 2003).

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requested items. Ultimately, they stopped cooperating with the developers. The developers retained **Richard A. Klass, Esq.,** *Your Court Street Lawyer,* to pursue their rights under the joint venture agreement, including suing for breach of contract and to enforce a constructive trust over the vacant lots.

In response to the developers' claims, the lot owners contended that they properly rejected the demand to transfer title to the property to the new LLC. They claimed that they were never provided with an operating agreement that named all four of the partners as members. The lot owners declared, "There was no way it was either reasonable or pursuant to the terms of the JVA that we were going to transfer the property worth at least $4,000,000.00 to an LLC in which we had no ownership interest and no control."

The developers asserted that this defense was pretext -- the lot owners never intended on complying with the joint venture agreement from the start. As fully laid out before the arbitrator, both in testimony and documentary evidence, the developers established that this defense was unfounded based on several facts: (1) the transfer tax documents, prepared by the title company, reflected all four joint venturers' names and respective 25% interests in the new LLC; [2] (2) One of the lot owners himself emailed the title company the names of all four people for the new LLC; (3) the developer emailed the mortgage lender that all four people were partners in the new LLC; (4) the developer informed the lot owner that the mortgage lender needed a draft of the operating agreement, Excel spreadsheet and all checks following; and (5) the developers made various, substantial payments in furtherance of their joint venture prior to any deed transfer.

The developers claimed that the lot owners wrongfully breached their fiduciary duty that was created when they entered into the joint venture.[3] As joint venturers, the developers asserted the lot owners owed them a fiduciary duty to supply financial information which was within their exclusive control and they breached their duty by intentionally failing to cooperate and disclose pertinent information. Cooperation on the part of both sides to a contract is implied in every contract. See, *Madison Pictures, Inc. v Pictorial Films, Inc*., 6 Misc 2d 302, 324-25 (Sup. Ct. 1956) ("Where a matter is particularly within the knowledge of one party, it is his duty to supply the information."); see also *Weeks v. Rector of Trinity Church in City of New York*, 56 App.Div. 195, 67 N.Y.S. 670, 672 (1st Dept. l900) ("The rule of law is that, when the obligation of performance by one party to a contract presupposes the doing of another act by the other party prior thereto, there arises an implied obligation of the second party to do the act which the performance of the contract necessarily…").

The arbitrator determined that the developers were entitled to compensation from the lot owners for their substantial investment of time and money into the project. The arbitrator awarded half of the value of the property along with reimbursement for all of their expenses.

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[2] It was noted that both the Joint Venture Agreement and the NYC Real Property Transfer (RPT) Tax Return served as documentary evidence of the respective LLC ownership interests of the parties. As held in *Matter of Pappas v Corfian Enterprises, Ltd*., 22 Misc 3d 1113(A) [Sup Ct 2009], affd, 76 AD3d 679 [2d Dept 2010]: "In the real world, particularly that in which close corporations operate, clear evidence of share ownership is often not found in the corporate books and records, for any number of reasons. Other evidence must be found, and the lodestar for admissibility and probative value must be the contractual foundation for shareholder status. A court may consider the intent of the parties, particularly evidence of an agreement to form a corporation. (See *Matter of Estate of Purnell v. LH Radiologists*, 90 N.Y.2d at 530, 664 N.Y.S.2d 238, 686 N.E.2d 1332; *Blank v. Blank*, 256 A.D.2d at 689, 681 N.Y.S.2d 377.) * * *

Documentary evidence may be particularly probative when the documents were created under circumstances in which there was no incentive to fabricate. Among the types of documents that courts have considered, and that have been proffered in this case, are corporate and personal tax returns, bank loan documents, and financial statements. (See *Matter of Capizola v. Vantage International, Ltd*., 2 A.D.3d at 845, 770 N.Y.S.2d 395; *Blank v. Blank*, 256 A.D.2d at 694, 681 N.Y.S.2d 377; *Hunt v. Hunt*, 222 A.D.2d at 761, 634 N.Y.S.2d 804.

[3] It is well settled that joint venturers are governed by the same good-faith requirements as co-partners and the creation of a joint venture "imposes a fiduciary relationship, and not a simple contract." *Learning Annex Holdings, LLC v Whitney Educ. Group, Inc*., 765 F Supp 2d 403, 412 [SDNY 2011]. In order to demonstrate a breach of fiduciary duty, there must be: "(i) the existence of a fiduciary duty; (ii) a knowing breach of that duty; and (iii) damages resulting therefrom." *N. Shipping Funds I, LLC v Icon Capital Corp*., 921 F Supp 2d 94, 101 (S.D.N.Y. 2013)(Citing *Johnson v. Nextel Communications, Inc.,* 660 F.3d 131, 138 (2d Cir. 2011)).

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