

**37 East 50th St. Corp. v Restaurant Group Mgt.  
Serv., LLC**

2014 NY Slip Op 31595(U)

June 19, 2014

Sup Ct, New York County

Docket Number: 653067/2013

Judge: Melvin L. Schweitzer

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37 East is a domestic corporation that owns the restaurant Maloney & Porcelli (the Restaurant), located at 37 East 50<sup>th</sup> Street (the Premises), New York, NY. 37 East is itself owned by the Pappas Group, which acts as their principals. RGMS is a domestic limited liability company that was retained by 37 East to provide administrative, managerial and operating services in connection with a restaurant operating in the Premises. RGMS currently owns and/or runs several restaurants in Manhattan, through their company, Fourth Wall Restaurants or other entities controlled by it.

As of 1996, the Pappas Group owned and operated Gloucester Café, a white tablecloth American restaurant, located at 37 East 50<sup>th</sup> Street in Manhattan. The Pappas Group also held long-term leases to the Premises. The operating lease was set to expire in 15 years, in 2011, and the ground lease in 19 years, in 2015.

In early 1996, the Pappas Group decided to close the Gloucester Café and hire a creative, high-end manager to design a new concept for a restaurant at the Premises. With that end in mind, the Pappas Group undertook negotiations with Alan Stillman, owner of RGMS, and reached an understanding that was reduced to writing. Prior to and at that time, Alan Stillman was well-known in Manhattan's high-end restaurant industry and had experience with creating and operating other high-end restaurants, such as Smith & Wollensky.

On April 18, 1996, 37 East and RGMS entered into the Initial Management Agreement, pursuant to which 37 East hired RGMS to operate and manage a new restaurant on the Premises.

The Initial Management Agreement expressly stated that 37 East held the operating and ground leases to the Premises and that, upon expiration of their stated terms, 37 East would renew and continue to hold those leases.

Pursuant to the Initial Management Agreement, RGMS would “provide new restaurant concept design, construction, administrative, managerial, and operating services in connection with the operation of the Restaurant.” The new restaurant, like the one it was replacing, was to “be constructed and operated as a first-class Manhattan Restaurant, with all white tablecloth service.”

The Pappas Group invested substantial moneys in the Restaurant and participated in the renovations and other expenses necessary to open the Restaurant. To safeguard this investment, and protect the interests of 37 East, the Initial Management Agreement required that RGMS act as a fiduciary of the Restaurant’s owner, 37 East, and its principal, the Pappas Group.

The Initial Management Agreement further required that RGMS document its expenses, providing “a monthly report of income, sales, expenses, cash flow, and balance sheet changes, including inventory” and “an annual financial statement of [the Restaurant’s] operations,” detailing “the cost of business licenses, taxes, insurance premiums, food, beverages, payroll servicing, salaries of employees at the Restaurant, office supplies, [and] advertising.

As consideration for its services, RGMS was entitled to a management services fee of three percent (3%) of all Restaurant sales. The Initial Management Agreement also provided in Article 4(a) that “[a]s additional compensation for its management services hereunder [RGMS] shall be paid by [37 East] a sum equal to the lessor [sic] of (i) 50% of the operating cash flow of [37 East] and (ii) cash flow of [37 East] minus the sums retained by [37 East] from operating cash flow under Article 4(b).” Article 4(b), in turn, set forth guaranteed payments by RGMS to 37 East. For the period post-dating 2004, such guaranteed payments to RGMS were \$480,000 per year. In sum, so long as the Restaurant generated sufficient operating cash flow, RGMS and

37 East would receive payments equal to 50 percent of such operating cash flow, subject to 37 East having received its guaranteed amount first.

RGMS's management of the Restaurant began the day Gloucester Café closed and, pursuant to the Initial Management agreement, would continue until RGMS "consents to a cessation of restaurant operations" or until either 37 East or RGMS terminates the Initial Management Agreement.

In relevant part, Article 10(B) of the Initial Management Agreement granted 37 East the right to terminate the Initial Management Agreement for "default" or "for cause." In order to terminate for "default," which term is not defined, 37 East was required to give RGMS notice of the default and 30 days to cure or "commence diligent effort[s] to cure." 37 East was also permitted to terminate "for cause," which definition includes "[a]ny act of willful misfeasance, fraud, bad faith or reckless disregard of the interest of [37 East] or [the Pappas or Skeadas families]."

"Upon any such termination," the Initial Management Agreement required that RGMS "immediately return control of the premises to [37 East], and guarantee that on such date of surrender, the Restaurant: (i) Shall have no debts whatsoever to any third party . . . ; (ii) and the furniture, fixtures and equipment of such premises will be free and clear of liens, encumbrances and chattel mortgages of any kind and description; and (iii) will be in compliance with all rules, regulations and licensing requirements of all state, federal, and local authorities."

Effective June 9, 2011, the day after the original lease expired, 37 East and RGMS entered into the Modification Agreement. The Modification Agreement reflected that RGMS was in the process of negotiating a new sublease for the Premises on behalf of 37 East and RGMS, and provided for a "New Lease," meaning "a sublease or an extension of the expired

sublease,” to be “entered into between Eurofinch, Ltd., as Landlord, and the Stillman Group and 37 East 50<sup>th</sup> Street Corporation, as Tenants,” and “naming the Stillman Group (or one of its affiliates) and 37 East 50<sup>th</sup> Street Corporation, as Tenants.”

Subject to the entry of such a “New Lease,” the Modification Agreement modified the parties’ economic rights under the Initial Management Agreement as follows: in exchange for a higher management fee, which increased to five percent (5%) from three percent (3%), and a higher share of the Restaurant’s operating cash flow, which increased from fifty percent (50%) to sixty-six and two-thirds percent (66 2/3%), and removal of the financial guarantee to 37 East, RGMS undertook to operate and manage the Restaurant “on a meaningful profitable basis” and agreed that if it failed to do so, it would lose all “decision-making with respect to the Restaurant.” Also, the Modification Agreement provided that “each party shall contribute its pro rata share (66 2/3% in the case of the Stillman Group and 33 1/3% in the case of the Pappas Group) of any capital determined by the parties to be required for the operation of the Restaurant at the Premises . . .”

In other words, the pressure of operating the Restaurant with positive operating cash flow (*i.e.* cash flow sufficient to provide disbursements) in light of the payment guarantees to 37 East was substituted by the requirement to operate it on a “meaningful profitable basis” at the threat of losing operational control. Likewise, with the increase of the financial upside, the Modification Agreement also imposed on the Stillmans the obligation to share in Restaurant expenses.

The operating lease for the Premises was set to expire on June 8, 2011. At the end of 2010, despite the Initial Management Agreement’s express contemplation that 37 East would

negotiate a renewal of its original lease, the Stillmans represented to the Pappas Group that they intended to negotiate a new lease.

The Stillmans and the Pappas Group agreed that this new lease would name each of them as tenants. The parties agreed that, rather than as the original lease being held solely by the Pappas Group, the Pappas Group and the Stillmans would both be named as tenants under the new lease. The Stillmans and the Pappas Group further agreed that the Stillmans would be responsible for negotiating this new lease.

In accordance with their understanding, the parties then entered into the Modification Agreement. The Modification Agreement specifically provides that RGMS was in the process of “negotiat[ing] the terms of a new sublease for the Premises to be entered into between Eurofinch, Ltd., as Landlord, and the Stillman Group and 37 East 50<sup>th</sup> Street Corporation, as Tenants.” As reflected in the Modification Agreement and communications between the parties, 37 East reposed its trust and confidence in RGMS to negotiate a new lease according to its terms. RGMS accordingly gained responsibility and assumed control of lease negotiations with the Landlord.

37 East alleges that when RGMS negotiated a new lease, it did so in order to benefit its own principals, and to the detriment of 37 East and its principals. 37 East does not appear on the new lease. Instead, the sole tenant named in the lease is a Stillman-controlled entity, MJS Entertainment, LLC (MJS).

Effective January 1, 2012, MJS entered into a new lease for the Premises with the Landlord (Stillman Lease). In the Stillman Lease, MJS represented and warranted to the Landlord that it was owned sixty-six and two-thirds percent (66 2/3%) by Fourth Wall Restaurants, which is in turn owned by the Stillmans, and purportedly owned thirty-three and

one-third percent (33 1/3%) by 37 East. Michael Stillman signed the lease on behalf of MJS, in his capacity as President and Founder of Fourth Wall Restaurants, the "Manager" of MJS.

Despite these representations and warranties, neither the Pappas group nor 37 East own any interest in nor are parties to any operating agreement for MJS. As the only tenant named on the Stillman Lease, MJS is entirely responsible for rent obligations. RGMS has, however, been making rental payments on MJS's behalf directly from an account of the Restaurant and deducting those payments from the Restaurant's operating cash flow as an "expense." In 2012 and 2013, RGMS deducted MJS's entire yearly rental obligation, some \$1,057,000, as an expense of the Restaurant. This amount exceeds 37 East's 1/3 share, commensurate with 37 East's interest in MJS. RGMS concealed these practices from 37 East by, among other things, providing limited and incomplete financial information for the Restaurant. On or about July 2013, 37 East was able to piece this financial puzzle together. When 37 East inquired as to these charges, RGMS refused to answer questions or provide further financial information to 37 East unless and until 37 East entered into a confidentiality agreement.

It has been RGMS's accounting practice for years prior and subsequent to 2011 to submit to 37 East inflated figures for income from restaurant operations, as these amounts failed to properly account for RGMS's management fee.

In 2012, the Restaurant lost money. After paying RGMS its five percent (5%) management fee, which came to some \$486,877, the Restaurant ended the year \$337,252 in the red. As a result, 37 East received no distributions whatsoever in 2012. The Restaurant continued to lose money in 2013. For the first seven months of 2013, RGMS provided 37 East with documents showing sales of \$5,504,703 and that the Restaurant's income from operations was \$209,304. However, this number failed to take into account RGMS's five percent (5%)

management fee, which comes to \$275,235. Thus, the management fee wiped out the income from restaurant operations and left the Restaurant, once again, in the red. In January 2013, the Restaurant posted a net loss of \$77,739, nearly \$60,000 more than it lost over the same period in 2012, without even taking into account RGMS's management fee which would increase the loss to more than \$114,000.

On July 19, 2013, 37 East issued RGMS a notice of termination by letter (the Termination Letter). 37 East terminated both for default and for cause. 37 East specified RGMS's defaults and breaches, including but not limited to its failure to operate the Restaurant on a meaningful profitable basis, its failure to conduct itself in a manner that takes into account 37 East's best interest and conduct itself free of bias and conflict of interest, and its failure to enter into a lease naming RGMS and 37 East as tenants, while reserving all of 37 East's rights with respect to any other potential claims against RGMS. 37 East provided RGMS with thirty-eight days, until August 2013, to surrender control over the Restaurant and make certain guarantees regarding the Restaurant's indebtedness and compliance with regulations.

Despite 37 East's termination of the Management Agreements, RGMS has failed to surrender the Restaurant and the Premises, and it continues to operate the Restaurant on a day-to-day basis and to make all management decisions regarding the Restaurant, without the consent and approval of 37 East.

37 East commenced this action asserting six causes of action. First, they seek damages for breach of contract based on RGMS's failure to pay 37 East the required amount under the Initial Management agreement for the years 2012 and 2013. Second, they seek specific performance for breach of contract based on RGMS's failure to act in 37 East's best interests when entering into the Stillman Lease, requiring RGMS to surrender the Premises and

operational control of the Restaurant and make the contractually-required guarantees as to the Restaurant, as well as that RGMS use its best efforts to have the Stillman Lease assigned to 37 East. Third, they seek a declaratory judgment for the Stillman Lease, stating that RGMS or its affiliate is responsible for 2/3 of the rent under the Stillman Lease, with 37 East responsible only for the remaining 1/3, with 37 East entitled to damages for any rent paid by RGMS on behalf of MJS out of the Restaurant revenues since January 1, 2012, in excess of 37 East's 1/3 share. Fourth, they bring an action for breach of fiduciary duty. Fifth, they bring a cause of action for breach of contract based on RGMS's use of the Restaurant's operating cash flow to pay the entirety of the rent, thereby causing 37 East to pay in excess of its rental payment obligation under the Modification Agreement. Sixth, they bring a cause of action for a breach of the implied covenant of bad faith and fair dealing.

RGMS asserts three counterclaims. First, they seek a declaratory judgment that 37 East is not entitled to terminate RGMS as manager of the Restaurant and that its purported termination notice is defective, ineffective, null and void. Second, they seek damages for breach of contract, based on 37's East's purported termination of RGMS. Third, they claim that 37 East's failure to contribute its pro rata share of 1/3 capital contributions, as per the Modification Agreement, amounts to a breach of contract entitling RGMS to damages.

37 East has moved to dismiss the first and second counterclaims, on the basis that the first counterclaim, for a declaratory judgment, is duplicative of the second counterclaim for breach of contract, and that the second counterclaim fails to adequately plead a claim for breach of contract, because RGMS has failed to allege any damage owing to the breach.

## Discussion

On a motion to dismiss for failure to state a claim, the court accepts all factual allegations pleaded in plaintiff's complaint as true and gives plaintiff the benefit of every favorable inference. CPLR 3211 (a) (7); *Sheila C. v Povich*, 11 AD3d 120 (1st Dept 2004). The court must determine whether "from the [complaint's] four corners[,] 'factual allegations are discerned which taken together manifest any cause of action cognizable at law.'" *Gorelik v Mount Sinai Hosp. Ctr.*, 19 AD3d 319, 319 (1st Dept 2005) (quoting *Guggenheimer v Ginzburg*, 43 NY2d 268, 275 (1977)). Vague and conclusory allegations, however, are not sufficient to sustain a cause of action. *Fowler v American Lawyer Media, Inc.*, 306 AD2d 113 (1st Dept 2003).

### The Breach of Contract Counterclaim

RGMS contends, in its second counterclaim, that 37 East was not entitled to terminate them under the terms of the Initial Management and Modification Agreements (the Agreements), because RGMS performed all of its obligations under the Agreements.

The elements of a claim for breach of contract under New York law are: (1) the existence of a valid, binding agreement between the parties; (2) performance by the moving party; (3) non-performance by the non-moving party; and (4) resulting damages. *Harris v Seward Park Hous. Corp.*, 79 AD3d 425 (1st Dept. 2010). A counterclaim for breach of contract is insufficient as a matter of law if it fails to "demonstrate how the counterclaim defendant's breach of the agreement caused counterclaim plaintiffs any injury." *ERE LLP v Spanierman Gallery, LLC*, 94 AD3d 492, 493 (1st Dept 2012) (quoting *Dino De Laurentiis Corp.*, 141 AD2d at 436. Because RGMS's counterclaim merely states that 37 East breached their otherwise valid and enforceable agreement by terminating RGMS despite their having performed all of their

obligations, and does not plead any particularized allegations of damages caused by 37 East's breach, RGMS's counterclaim for breach of contract is insufficient as a matter of law.

RGMS claimed, in response to 37 East's motion to dismiss the second counterclaim, that the termination of the Management Agreement and subsequent commencement of this action would result in reputational harm giving rise to lost profits that may be recovered in the form of damages for breach of contract. This claim is not supported by New York law.

Loss of future profits as damages for breach of contract under New York law requires that the following elements be shown: (1) "it must be demonstrated with certainty that such damages have been caused by the breach"; (2) the alleged loss must be capable of proof with reasonable certainty. In other words, the damages may not be merely speculative, possible or imaginary, but must be reasonably certain and directly traceable to the breach, not remote or a result of other intervening causes"; (3) "there must be a showing that the particular damages were fairly within the contemplation of the parties to the contract when it was made." *Kenford Co. v County of Erie*, 67 NY2d 247, 261 (1986). Any reputational harm that might result from 37 East's termination of its agreements with RGMS (assuming they were in breach) is purely speculative, considering that RGMS rejected their notice of termination and continues to manage the restaurant. RGMS has not alleged that the harm was fairly within the contemplation of the parties at the time they entered into the Agreements.

RGMS is not entitled to damages for reputational harm on the basis of 37 East's commencement of this lawsuit. Commencement of a lawsuit is not a valid basis for reputational harm giving rise to damages, unless it is alleged that the lawsuit was initiated maliciously and/or constitutes abuse of process. *Rubin v Lufty*, 906 NYS2d 783, N.Y. Slip Op. 52553(U), at \*9.

RGMS's counterclaim does not allege that 37 East has abused process by bringing suit against them. Therefore, they are not entitled to damages on the basis of the fact of the lawsuit itself.

RGMS is entitled to bring a breach of contract claim in pursuit of nominal damages. "Nominal damages are always available in breach of contract actions." *Kronos, Inc. v AVX Corp.*, 81 NY2d 90, 95 (1993). Nominal damages are a way of recognizing the fact that harm is caused by the fact of one party's breaking its contractual promise to another, apart from any measurable form of damages that might be alleged in a traditional breach of contract claim for monetary damages. "[A] party's rights in contract arise from the parties' promises and exist independent of any breach. Nominal damages allow vindication of those rights." *Kronos* at 96. Therefore, a claimant need not allege damage in order to be entitled to nominal damages for breach of contract.

RGMS has pled the first three elements of a breach of contract claim. They have pled: that "[t]he Initial Management Agreement, as modified by the Modification Agreement, is a valid and enforceable agreement." ; that "RGMS has performed all of its obligations in connection with the matters described herein pursuant to the parties' agreement."; and that "37 East's purported termination is in breach of the Initial Management Agreement and the Modification Agreement." Taken together, these pleadings are sufficient to establish a claim for nominal damages. "Nominal damages . . . satisfy the damages element of a breach of contract claim under New York law." *Baskin-Robbins Inc. v S&N Prinja, Inc.*, 78 F Supp 2d. 226, 232 (SDNY 1999).

#### The Declaratory Judgment Counterclaim

37 East has moved to dismiss RGMS's counterclaim seeking declaratory relief that 37 East is not entitled to terminate RGMS as manager and that the purported termination notice

is defective, ineffective, null and void, on the basis that it is entirely duplicative of RGMS's breach of contract counterclaim.

Although as a general matter, a court's grant of declaratory relief is discretionary (CPLR 3001), [a] cause of action for declaratory judgment is unnecessary and inappropriate when the plaintiff has an adequate, alternative remedy in another form of action, such as breach of contract." *Apple Records, Inc. v Capitol Records, Inc.*, 137 AD2d 50, 54 (1st Dept 1988). While it is true that "[t]he co-existence of a different remedy should not, by itself, preclude declaratory judgment," *Schatten v Universal Security Systems, Inc.*, No. 018419/2007, 2008 WL 4203225 (Sup Ct Suffolk Cnty May 20, 2008), when a declaratory judgment is sought based on the same transactions and occurrences as an action for breach of contract, it will be subject to dismissal as a matter of law. *Bodner v Grunstein*, No. 650791/2010, 2011 WL 11076595 (Sup Ct NY Cnty Jul 6, 2011). RGMS's declaratory judgment counterclaim is duplicative of the breach of contract one and should be dismissed. The court's decision with respect to the nominal damages claim would necessarily serve to "settle the legal issues involved, finalize any controversy and offer relief from uncertainty." The exact same determinations (as to what the respective rights and duties of the parties were under the contract, and whether 37 East legitimately terminated the Agreements) are required for either remedy to be granted.

RGMS's contention that it is entitled to at least plead for declaratory judgment in the alternative is also meritless. There is nothing accomplished by pleading such a claim in the alternative, particularly in light of the purpose of alternative pleading – to create a legal fiction that two mutually exclusive claims may coexist, such that if one is disproven the other may still be proven. There is no situation where the nominal damages claim would be denied and the declaratory judgment would be granted, and so pleading in the alternative would not solve the

redundancy problem posed by pleading for nominal damages and declaratory relief cumulatively.

### Conclusion

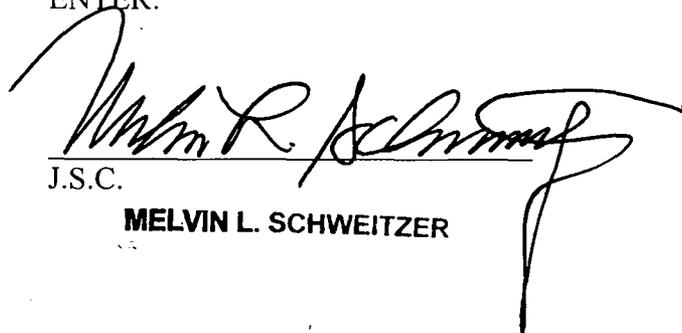
Accordingly, it is

ORDERED that 37 East's motion to dismiss RGMS's first counterclaim is granted; and it is further

ORDERED that 37 East's motion to dismiss RGMS's second counterclaim is granted with respect to any claim for monetary damages, and denied with respect to a claim for nominal damages.

Dated: June 19, 2014

ENTER:



J.S.C.

**MELVIN L. SCHWEITZER**