SUPREME COURT OF THE STATE OF NEW YORK — NEW YORK COUNTY

PRESENT: BARBARA R. KAPNICK Justice PART 39

YL Sheffield

- v -

Wells Fargo

INDEX NO. 601782/09

MOTION DATE

MOTION SEQ. NO. 07

MOTION CAL. NO.

The following papers, numbered 1 to _____ were read on this motion to/for _____

	PAPERS NUMBERED
Notice of Motion/ Order to Show Cause — Affidavits — Exhibits ...	
Answering Affidavits — Exhibits	
Replying Affidavits	

Cross-Motion: ☐ Yes ☒ No

Upon the foregoing papers, it is ordered that this motion

MOTION IS DECIDED IN ACCORDANCE WITH
ACCOMPANYING MEMORANDUM DECISION

MOTION/CASE IS RESPECTFULLY REFERRED TO JUSTICE FOR THE FOLLOWING REASON(S):

Dated: 3/20/12

BARBARA R. KAPNICK J.S.C.
J.S.C.

Check one: ☐ FINAL DISPOSITION ☒ NON-FINAL DISPOSITION

Check if appropriate: ☐ DO NOT POST ☐ REFERENCE

SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK: IA PART 39

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YL SHEFFIELD LLC and SH 57th LLC, individually and derivatively on behalf of 322 WEST 57th LLC, 322 WEST 57th OWNER LLC, 322 WEST 57th I LLC, 322 WEST 57th II LLC, 322 WEST 57th III-A LLC, 322 WEST 57th III-B LLC, 322 WEST 57th III LLC, and 322 WEST 57th IV LLC,

Plaintiffs,

-against-

WELLS FARGO BANK, N.A., AS TRUSTEE FOR THE CREDIT SUISSE FIRST BOSTON MORTGAGE SECURITIES CORP. COMMERCIAL MORTGAGE PASS-THROUGH CERTIFICATES SERIES 2006 TFL2, KEYCORP REAL ESTATE CAPITAL MARKETS, INC., GUGGENHEIM STRUCTURED REAL ESTATE FUNDING 2006-3, LTD., GUGGENHEIM STRUCTURED REAL ESTATE FUNDING 2006-4, LTD., GSRE-CS II, LTD., SSPF/I&G SHEFFIELD, LLC, PETRA FUND REIT CORP., GRAMERCY WAREHOUSE FUNDING I LLC, NYLIM REAL ESTATE MEZZANINE FUND II, L.P., MMA REALTY CAPITAL, LLC, SE WEST 57 PROPERTY, LLC, SE WEST 57 MANAGEMENT, LLC, KENT SWIG, SWIG EQUITIES, LLC and FALCON PACIFIC CONSTRUCTION, LLC,

Defendants,

434 M LLC and 434 Holdings II LLC,

Substituted Defendants,

322 WEST 57th OWNER LLC, 322 WEST 57th I LLC, 322 WEST 57th II LLC, 322 WEST 57th III-A LLC, 322 WEST 57th III-B LLC, 322 WEST 57th III LLC, 322 WEST 57th IV LLC, and 322 WEST 57th LLC.

Nominal Defendants.

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DECISION/ORDER
Index No.601782/2009
Motions Seq. Nos.
007 and 009

BARBARA R. KAPNICK, J.:

Motions sequence numbers 007 and 009 are consolidated herein for disposition.

In this action, plaintiffs seek recovery for losses resulting from defendants' alleged nefarious conduct relating to the condominium conversion of an 845-unit apartment building located at 322 West 57th Street in Manhattan, known as the Sheffield (the "Property"). The Amended Complaint contains 16 causes of action asserting derivative and direct claims for corporate waste, mismanagement, breach of fiduciary duty, aiding and abetting breach of fiduciary duty, breach of contract, money had and received, conversion, injunctive and declaratory relief, appointment of a receiver, an accounting, imposition of a constructive trust, and civil conspiracy.

By Stipulation dated September 17, 2009, this action was voluntarily dismissed against defendants Gramercy Warehouse Funding I LLC, Petra Fund REIT Corp., SSPF/I&G Sheffield, LLC, NYLIM Real Estate Mezzanine Fund II, L.P., and MMA Realty Capital, LLC. By judgment dated June 29, 2010, this action was discontinued with prejudice against defendants 434 M LLC and 434 Holdings II LLC (together the "434 Entities"), and Guggenheim Structured Real Estate Funding 2006-3, Ltd., Guggenheim Structured Real Estate

Funding 2006-4, Ltd., and GSRE-CS II, Ltd. (together, "Guggenheim"). Plaintiffs now concede that the Court's prior decisions have effectively mooted several causes of action, and, in their opposition brief, plaintiffs withdrew their seventh, eighth, ninth, tenth, thirteenth, fifteenth, and sixteenth causes of action.

In motion sequence number 007, defendants Kent Swig ("Swig"), Falcon Pacific Construction, LLC ("Falcon"), SE West 57 Management, LLC ("SE Management"), SE West 57 Property, LLC ("SE Property") (collectively, the "SE Defendants"), and Swig Equities, LLC ("Swig Equities") move to dismiss the remaining causes of action asserted against them, based upon documentary evidence (CPLR 3211 [a][1])and for failure to state a cause of action (CPLR 3211[a][7]). In motion sequence number 009, defendants KeyCorp Real Estate Capital Markets, Inc. ("KeyCorp") and Wells Fargo Bank, N.A. ("Wells Fargo") move to dismiss the remaining causes of action asserted against them, based upon lack of standing, documentary evidence, equitable principles and for failure to state a cause of action.

Factual Allegations

On April 4, 2005, defendants SE Management and SE Property, and plaintiffs YL Sheffield LLC ("YL") and SH 57th LLC ("SH"),

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entered into a Limited Liability Company Agreement (the "Operating Agreement") to form 322 West 57th LLC (the "Company"), for the purpose of acquiring, operating, renovating and converting the Property, and selling condominium units through a series of subsidiaries. The Company was owned 40% by YL, 30% by SH, 29.99% by SE Property, and 0.01% by SE Management. According to the Amended Complaint, SE Management is owned, in whole or in substantial part, and controlled by Swig, and Swig and his entities owned a 30% interest in SE Property. Under the Operating Agreement, YL, SH, SE Management, and SE Property are the sole equity and co-managing members of the Company. (Operating Agreement, section 5[b]). SE Management was also named "Operations Manager" and, in this capacity, was responsible for the "day-to-day business and affairs of the Company." *Id.*

In May 2005, the Company acquired the Property for $418 million through the subsidiary 322 West 57th Owner LLC ("57th Owner LLC"). To fund the acquisition, YL and SH made initial capital contributions of approximately $17 million, and SE Property contributed approximately $7.5 million. Prior to the acquisition, on April 6, 2005, 57th Owner LLC and other subsidiaries of the Company entered into various mortgage and mezzanine loan agreements, for a total debt financing of approximately $518 million, to finance the acquisition and renovation costs of the

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Property. Specifically, 57th Owner LLC, as senior borrower, entered into a Senior Loan Agreement with Column Financial, Inc. ("Column") of approximately $165 million, secured by a first mortgage lien on the Property (the "Senior Loan"). The same day, 57th Owner LLC entered into a Senior Building Loan Agreement with Column, whereby Column committed to loaning $38 million to 57th Owner LLC as a building loan, secured by a second mortgage lien against the Property (the "Senior Building Loan"). Also on April 6th, 57th Owner LLC entered into a Senior Project Loan Agreement with Column, whereby Column committed to loaning approximately $14 million to finance the soft costs associated with the acquisition, secured by a third mortgage lien against the Property.

Concurrent with the April 6, 2005 closing of these mortgage loans, Column entered into agreements to provide mezzanine financing to the Company's nominal subsidiaries. Column agreed to loan 322 West 57th I LLC approximately $58 million, secured by a pledge of its 100% of the membership interests in 57th Owner LLC. Column agreed to loan 322 West 57th II LLC approximately $103 million, secured by a pledge of 100% of the membership interests in 322 West 57th I LLC. Column agreed to loan 322 West 57th III LLC $108 million, secured by a pledge of its 100% of the membership interests in 322 West 57th II LLC. Column also agreed to loan 322

West 57th IV LLC $32 million, secured by a pledge of 100% of the membership interests in 322 West 57th III LLC.

On July 6, 2006, with the need for additional financing to complete the renovation work at the Property, the Company's members entered into an Amendment to the Operating Agreement (the "Amended Operating Agreement"). The Amended Operating Agreement required SE Property and SE Management to contribute an additional $12 million as a condition to the contemplated refinancing. (Section 5[c]). The next day, July 7th, 57th Owner LLC and Column entered into an Amended and Restated Building Loan Agreement, refinancing the $38 million Senior Building Loan to increase the construction budget to approximately $85 million (Section 2.1.1). As with the initial Senior Building Loan, the amended loan was secured by a second mortgage lien against the Property; in addition, 57th Owner LLC executed a note payable to Column in the principal amount of the loan. According to plaintiffs, Column assigned the refinanced Senior Building Loan, the mortgage, and the note to Wells Fargo, and KeyCorp became the servicer of the Senior Building Loan.

According to the Amended Complaint, the mezzanine loans were replaced in their entirety in July 2006, and three months later these loans were "re-shuffled" and sold in the secondary market. Amended Complaint, ¶¶ 59, 61. Specifically, on July 7, 2006,

pursuant to various mezzanine loan agreements, Column made the following mezzanine loans: $50 million to 322 West 57th I, LLC, which was increased to $70 million by an amended agreement dated October 20, 2006; $50 million to 322 West 57th II, LLC, which was increased to $60.5 million by an amended agreement dated October 20, 2006; $108 million to 322 West 57th III, LLC, which was reduced to $27 million by an amended agreement dated October 20, 2006; and $32 million to 322 West 57th IV, LLC. The reduction of the loan to 322 West 57th III, LLC allegedly enabled nominal defendant 322 West 57th III-A, LLC (the new sole member of 322 West 57th II LLC) and nominal defendant 322 West 57th III-B, LLC (the new sole member of 322 West 57th III-A, LLC) to receive loans of $17.5 million and $33 million, respectively, on October 20, 2006.

Plaintiffs allege that, while the re-shuffling of the loans did not result in immediate changes in interest rates, the re-shuffling was designed to heavily favor the lenders in the long-run. Specifically, plaintiffs allege that the October 2006 re-shuffling resulted in the Senior Loan, Senior Building Loan, and Project Loan rates decreasing from 2.2375% to 1.77%, while the first and second mezzanine loan rates increased from 1.5% to 2.5% and 5%, respectively. *Id.*, ¶ 78. In addition, the new October 2006 mezzanine loans to 322 West 57th III-A, LLC and 322 West 57th III-B, LLC had interest rates of 6% and 8%, respectively, and the third

mezzanine loan rate increased from 6.75% to 10%. *Id.* Plaintiffs claim that the Senior Building Loan was aggressively paid down from condominium sales proceeds, while mezzanine loans remained unpaid. *Id.*, ¶ 80. Thus, according to plaintiffs, the debt stack decreased the Senior Building Loan but dramatically increased the interest rates and payments on the mezzanine loans over time, requiring the Company and its subsidiaries - the mezzanine borrowers - to pay higher interest rates for a longer period of time. *Id.*, ¶¶ 70-80.

According to plaintiffs, Swig entered into the mezzanine loan agreements and related loan documents for the loans to 322 West 57th III-A and III-B, LLC, on behalf of these borrowers, without seeking or obtaining plaintiffs' allegedly required consent. *Id.*, ¶ 76. Plaintiffs also allege that Column and Wells Fargo possessed copies of the Operating and Amended Operating Agreements relating to the mezzanine borrowers, and that, therefore, they knew plaintiffs' consent was required. *Id.*. The re-shuffling also allegedly rendered the "overall loan terms materially more adverse to the Company and its subsidiaries" *id.*, ¶ 80, creating "terms materially worse to borrowers than existed [previously]" *id.*, ¶ 90, and Swig's failure to obtain plaintiffs' consent under the Operating and Amended Operating Agreements rendered the October 2006 loan documents ultra vires. Id., ¶ 85.

The Operating Agreement also provided for the payment of a "Developer's Fee" to "the Developer for the supervision of the development of the Project in an amount equal to one percent (1%) of the construction costs of the Project." (Operating Agreement, Schedule A, at A-5). "Developer" was defined as "each of the Member Principals or any Affiliate of each of them". *Id.* "Member Principal," in turn, was defined as "Swig in the case of SE," Serge Hoyda, in the case of SH, and Yair Levy, in the case of YL. *Id.* at A-8. Plaintiffs claim that Swig, SE Property, SE Management, and Falcon received construction costs of $88,659,213 under the Senior Building Loan, thereby generating a Developer's Fee of $886,592, of which plaintiffs' portion was never paid. Plaintiffs also claim that these defendants used millions of dollars of Senior Building Loan proceeds to pay for costs unrelated to the project, such as Swig's other, unrelated development projects, legal fees incurred by Swig in unrelated matters, and costs relating to Swig's residential apartment. Amended Complaint, ¶ 96-98. Plaintiffs aver that only approximately $50 million of that $88 million was requisitioned for invoices due to nonparty Pinnacle Contractors of NY, Inc. ("Pinnacle"), the contractor hired by Falcon, and, according to plaintiffs, Pinnacle claims that it is owed an additional $14 million, resulting in $52 million in unaccounted for Senior Building Loan proceeds. *Id.* ¶¶ 99-100.

The Amended Senior Building Loan Agreement contemplated the hiring of a "Construction Consultant," defined in the agreement as nonparty "Inspection and Valuation International Inc.," to "inspect the Improvements and the Property as construction progresses and consult with and to provide advice to and to render reports to Lender," including "consulting architects, engineers or inspectors appointed by Lender." (Amended and Restated Building Loan Agreement, at 7). This agreement also provided that the Construction Consultant would, among other things, advise Column whether "the construction of the Project Improvements [were] proceeding satisfactorily and according to schedule," and whether "the work on account of which the Advance is sought has been or will be completed in a good and workmanlike manner to such Construction Consultant's reasonable satisfaction within cost estimates approved by Lender and substantially in accordance with the Plans and Specifications" *Id.*, § 2.9.3[j]. According to plaintiffs, by July 2008, over $88 million in Senior Building Loan proceeds had been advanced (approximately $3 million more than the full amount of the loan), yet a substantial amount of construction work had not been completed. Plaintiffs claim that this created a "grossly out of balance condition," and that "millions of dollars were being siphoned off by the Swig Defendants and not benefitting the Project at all," while Wells Fargo and KeyCorp improperly

continued to fund the project with Senior Building Loan proceeds. Amended Complaint, ¶¶ 108, 110.

In February, July, October and November 2008, Swig allegedly entered into Forbearance and Modification Agreements, on behalf of 57th Owner LLC and the mezzanine borrowers, with Wells Fargo and other mezzanine lenders,[1] but without obtaining plaintiffs' prior approval to do so. Under these agreements, 57th Owner LLC allegedly failed to remit to Wells Fargo certain net proceeds from condominium sales, and Wells Fargo held condominium sales proceeds instead of applying those proceeds to outstanding loan debt. The February 2008 agreement also required payment of a $5,161,371 "Modification Fee," and the July 2008 agreement required "Special Payments," totaling $3,447,527, to be paid from excess sales proceeds from the sale of condominium units. Amended Complaint, ¶¶ 111-130. These payments were allegedly made to Wells Fargo and the other mezzanine lenders. As with the 2006 mezzanine loans, plaintiffs claim that the failure to obtain their consent, and Wells Fargo and the other mezzanine lenders' knowledge that

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[1] According to the Amended Complaint, the other mezzanine lenders included Guggenheim, and the following defendant entities, which were assigned the mezzanine loans by Column: Gramercy Warehouse Funding I LLC, Petra Fund REIT Corp., SSPF/I&G Sheffield, LLC, NYLIM Real Estate Mezzanine Fund II, L.P., and MMA Realty Capital, LLC.

plaintiffs' consent was required, renders these Forbearance and Modification Agreements ultra vires.

Plaintiffs claim that they attempted to inform the lenders of Swig's purportedly improper conduct. KeyCorp allegedly refused to communicate with plaintiffs. According to plaintiffs, Wells Fargo, KeyCorp, and Guggenheim[2] knew that Swig's actions were improper under the Operating and Amended Operating Agreements but ignored Swig's conduct because they sought to "over-advance their loans, create defaults, and sell their loans as 'loans to own' based upon their over-secured positions." *Id.*, ¶ 137. In May 2009, KeyCorp and Guggenheim notified 57th Owner LLC and 322 West 57th I LLC that they were in default and demanded payment of their full outstanding debts.

On June 17, 2009, without plaintiffs' consent, Swig allegedly caused the Company, Swig Equities, SE Property, SE Management, Falcon, and nonparty Swig Burris Equities, LLC to enter into a Cooperation Agreement with the 434 Entities (through their parent company, Fortress. *Id.*, ¶¶ 140-142. As a condition to entering

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[2] According to the Amended Complaint, Column assigned Guggenheim all of its right, title and interest in 322 West 57th I LLC's July 2006 mezzanine loan. *Id.*, ¶ 63. Plaintiffs also claim that, as a result, Guggenheim, as bondholder or participant, owned the first-loss position in the Senior Building Loan, the Senior Loan, and the Senior Project Loan. *Id.*, ¶ 60.

into the Cooperation Agreement, Swig allegedly caused SE Property, SE Management, Falcon, 57th Owner LLC, and the Company to enter into an Omnibus Agreement, also without plaintiffs' consent. Plaintiffs claim that the Cooperation and Omnibus Agreements conferred benefits upon Swig and his entities that were not provided to plaintiffs. Amended Complaint, ¶¶ 145-146, 154-155. Plaintiffs further claim that, according to the Cooperation Agreement, the 434 Entities were formed to, and in fact already have, acquired from Guggenheim the mezzanine loan of 322 West 57th I, LLC and Wells Fargo's interest in the Senior Loan, the Senior Building Loan, and the Senior Project Loan. *Id.*, ¶ 43.

According to the Amended Complaint, the 434 Entities intended to foreclose on the loans and become the owner of the Property. *Id.*, ¶ 143. In a Notice of Disposition of Collateral dated June 23, 2009, 434 M LLC indicated its intention to auction its collateral for the first mezzanine loan - that is, its membership interests in 57th Owner LLC, which owns the unsold condominium units - at a foreclosure sale. *Id.*, ¶ 148. At the time of the filing of the Amended Complaint, 57th Owner LLC owned title to 213 unsold units, with an alleged market value of $300 million. *Id.*, ¶149. According to Swig, at a foreclosure sale held on August 6, 2009, pursuant to article 9 of the Uniform Commercial Code, the 434 Entities purchased the collateral underlying the first mezzanine

loan. Swig Aff., ¶ 90; *see also* 4/20/10 Tr., at 8 (counsel for Wells Fargo and KeyCorp represented that the loan was sold to the 434 Entities, who "bought the property back out of foreclosure").

The Amended Complaint claims that Swig was involved in additional wrongful conduct, such as causing 57th Owner LLC to enter into an Exclusive Sales Agency Agreement with Swig Equities, on October 16, 2006, without plaintiffs' consent, and subsequently failing to pay 57th Owner LLC commissions earned under that agreement. Swig also allegedly failed to pay common charges for unsold units, as required under the condominium's by-laws, and invaded the condominium reserve fund of 57th Owner LLC, using the funds to pay unrelated legal fees. These actions resulted in a separate proceeding being commenced by residents of the condominium, which Swig allegedly settled without plaintiffs' consent in violation of the Operating Agreement.[3]

Legal Analysis

SE Defendants & Swig Equities (Motion Sequence No. 007)

The Operating Agreement provides that it is governed by Delaware law, and it is undisputed that the Company is a Delaware

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[3] See so-ordered Stipulation dated June 4, 2009 in *Matter of Wagner v Board of Mgrs. of the 322 W. 57th St. Condominium* (Sup Ct, NY County, Index No. 106231/09) (the "Wagner Proceeding").

limited liability company. Therefore, Delaware law applies to plaintiffs' derivative claims concerning the Company's corporate governance. *Hart v General Motors Corp.*, 129 AD2d 179, 182-83 (1st Dept 1987), *app den* 70 NY2d 608 (1987).

Plaintiffs' first, fifth, sixth, eleventh[4] and twelfth causes of action are asserted derivatively on behalf of the Company and its various direct and indirect subsidiaries. Under Delaware law, "[i]n a derivative action, the plaintiff must be a member or an assignee of a limited liability company interest at the time of bringing the action." 6 Del C § 18-1002. Here, plaintiffs are members of the Company, but they do not respond to defendants' argument that they lack standing, under section 18-1002 of the Delaware Code, with respect to the Company's subsidiaries, including the mezzanine borrowers and 57th Owner LLC. Nevertheless, plaintiffs appear to be asserting double derivative claims on behalf of the mezzanine financing entities - that is, "a derivative action maintained by the shareholders of a parent corporation or holding company on behalf of a subsidiary company" - which is clearly permitted under both Delaware and New York law. *Sternberg v O'Neil*, 550 A2d 1105, 1107 n 1 (Del 1988); *VGS, Inc. v Castiel*, 2003 WL 723285, *11 (Del Ch 2003) ("case law governing corporate

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[4] The eleventh cause of action is asserted derivatively only against the Lender defendants.

derivative suits is equally applicable to suits on behalf of an LLC"); *Pessin v Chris-Craft Indus.*, 181 AD2d 66 (1st Dept 1992); *Kaufman v Wolfson*, 1 AD2d 555, 557 (1st Dept 1956). Therefore, plaintiffs' derivative claims are permitted, to the extent asserted on behalf of 322 West 57th I LLC, 322 West 57th II LLC, 322 West 57th III-A LLC, 322 West 57th III-B LLC, 322 West 57th III LLC, and 322 West 57th IV LLC.

However, the Delaware Supreme Court has ruled that "[a] plaintiff who ceases to be a shareholder, whether by reason of a merger or for any other reason, loses standing to continue a derivative suit." *Lewis v Anderson*, 477 A2d 1040, 1049 (Del 1984); *Lewis v Ward*, 852 A2d 896, 900-904 (Del 2004). Here, it is undisputed that the 434 Entities acquired 57th Owner LLC, thereby nullifying plaintiffs' indirect ownership interests in that entity through the Company and precluding any derivative claim by plaintiffs on behalf of 57th Owner LLC. Thus, plaintiffs do not have standing to bring claims on behalf 57th Owner LLC, and the first, fifth, sixth, eleventh and twelfth causes of action are dismissed to the extent asserted by this entity.

I. Breach of Fiduciary Duty (1st and 2nd Causes of Action)

The first cause of action, asserted derivatively, alleges that the SE Defendants committed corporate waste, mismanagement, and breached fiduciary duties by diverting Senior Building Loan

proceeds for Swig's other projects and personal expenses, and by entering into the above-described unauthorized transactions with affiliates and lenders. Based upon the same allegations, the second cause of action asserts a direct claim of breach of fiduciary duty against the SE Defendants. The SE Defendants argue that both causes of action should be dismissed, because: the loan re-shuffling, Falcon's appointment as Construction Manager, and the Loan Modification Agreements were permitted under the parties' agreements; the allegations of misappropriation lack specificity, even though plaintiffs had access to all the financial information concerning the project; plaintiffs consented to the Exclusive Sales Agency Agreement and were not entitled to commissions thereunder until they repaid outstanding Member Loans; and the condominium reserve funds were never misused and any common charges have been paid in full.

In order to plead a breach of fiduciary duty under Delaware law, "the complaint must set forth facts tending to rebut the business judgment rule's 'presumption that in making a business decision the directors of a corporation acted on an informed basis, in good faith and in the honest belief that the action taken was in the best interests of the company.'" *Golaine v Edwards*, 1999 WL 1271882, *10, 1999 Del Ch LEXIS 237, *34 (Del. Ch. Dec. 21, 1999), citing *Aronson v Lewis*, 473 A2d 805, 812 (Del 1984). "The burden is on the party challenging the decision to establish facts

rebutting the presumption" (*Aronson*, 473 A2d at 812), by showing "that the directors breached their fiduciary duty of care or of loyalty or acted in bad faith," in which case "the burden then shifts to the director defendants to demonstrate that the challenged act or transaction was entirely fair to the corporation and its shareholders." *In re Walt Disney Co. Derivative Litig.*, 906 A2d 27, 52 (Del Supr 2006). However, if the pleading contains sufficient allegations to show "a lack of ... disinterested independence or [a] dual relation, the complaint may not be dismissed for failure to state a cause of action solely upon application of the business judgment rule." *S.H. and Helen R. Scheuer Family Found. v 61 Assoc.*, 179 AD2d 65, 69-70 (1st Dept 1992).

> [Corporate] waste entails an exchange of corporate assets for consideration so disproportionately small as to lie beyond the range at which any reasonable person might be willing to trade. Most often the claim is associated with a transfer of corporate assets that serves no corporate purpose; or for which no consideration at all is received. Such a transfer is in effect a gift. If, however, there is *any substantial* consideration received by the corporation, and if there is a *good faith judgment* that in the circumstances the transaction is worthwhile, there should be no finding of waste, even if the fact finder would conclude *ex post* that the transaction was unreasonably risky.

Brehm v Eisner, 746 A2d 244, 263 (Del Supr 2000) (emphasis in original).

As a preliminary matter, it is axiomatic that "in the absence of a contrary provision in the LLC agreement, the manager of an LLC owes the traditional fiduciary duties of loyalty and care to the members of the LLC." *Bay Ctr. Apts. Owner, LLC v Emery Bay PKI, LLC*, 2009 WL 1124451, *8, 2009 Del Ch LEXIS 54, *26 (Del Ch 2009). However, Swig Equities and Falcon are not alleged to be members of the Company. Rather, plaintiffs allege that these entities had, at most, a contractual relationship with the Company or its subsidiaries to perform certain services. Without more, these allegations do not create a fiduciary relationship with plaintiffs. Because the first and second causes of action rely upon the existence of a fiduciary relationship (Amended Complaint, ¶¶ 192, 196), both claims are dismissed to the extent asserted against Swig Equities and Falcon.[5]

A. Loan Re-shuffling

There is no dispute that SE Property, SE Management, and Swig, as the sole member of SE Management, owed fiduciary duties to the

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[5] The first and second causes of action are asserted against "the Swig Defendants" (Amended Complaint, at 47-48), which the pleading defines as including Falcon, SE Management, SE Property, and Swig. *Id.* at 2. Swig Equities is excluded from the definition and, therefore, presumably, these claims were not intended to be asserted against Swig Equities. Because the 60-page Amended Complaint contains numerous defined terms, including definitions for dozens of entities, for clarity, the Court's decision includes dismissal of the first two causes of action to the extent asserted against Swig Equities.

Company and plaintiffs. With respect to the loan re-shuffling (Amended Complaint, ¶¶ 48-90), plaintiffs allege that, pursuant to the loan documents, Column was permitted to adjust the loans, as long as "the initial weighted average interest rate did not change" and the terms of any purported "'re-shuffling'" of loan balances and interest rates could not be "materially worse to the Company and its subsidiaries, as borrowers." *Id.*, ¶ 58.

However, section 12.1.2(a) of the Amended and Restated Building Loan Agreement expressly permitted Column to "establish different interest rates for each of the Mortgage Loan and the Mezzanine Loan between each other and to require the payment of the Mortgage Loan and the Mezzanine Loan in such order of priority as may be designated by Lender." Section 12.1.2(b) contained similar language, permitting Column to create new mezzanine loans - such as the III-A and III-B loans - and to "establish different interest rates and to reallocate principal balances of each of the Mortgage Loan, the Mezzanine Loan and any New Mezzanine Loan(s)." Plaintiffs concede that "the Senior Building Loan was being aggressively amortized" (Amended Complaint, ¶ 80), and the Amended and Restated Building Loan Agreement expressly acknowledged the potential for fluctuations in the weighted average spread, "provid[ing], further, that *such modifications may as a result of prepayments subsequently change the weighted average spread.*"

§ 12.1.2(a) (emphasis added). Thus, the alleged impropriety concerning the loan re-shuffling was permitted under the parties' agreement.

Nor was SE Management, as Operations Manager, required to obtain plaintiffs' consent prior to re-shuffling the loans. Section 9 of the Operating Agreement was titled "Management," and section 9(i) was titled "Restrictions on Operations Manager and Members." Section 9(i)(ii) provided, in relevant part, as follows:

> Unanimous Decisions. ... no Member or Members shall, without obtaining the prior Unanimous Consent of the Managing Members, have the right, power or authority to do or take, or to permit or cause the Company or Project Owner to ... (B) incur any financing in addition to the Financing or renew, extend, add to, supplement, materially amend or modify, increase or restructure any borrowing by the Subsidiaries or Project Owner, or replace the Financing whether or not secured by Company assets or the Project; ... .

However, 15 months later, the Amended Operating Agreement expressly deleted the "Unanimous Decisions" language, which plaintiffs concede resulted in enlarging Swig's authority (Amended Complaint, ¶ 52), as it left the Operations Manager, SE Management, with much greater authority. Specifically, absent the unanimous consent provision, the Operating Agreement provided that:

[* 23]

> the Operations Manager shall be responsible for supervising and undertaking the business of the Company ... In connection therewith, the Operations Manager shall ... have the right, power and authority, at such times as the Operations Manager shall determine without additional consultation, authorization, consent or ratification of any Member ... to permit or cause the Company to ... (v) subject to Section 9(i), enter into, execute, amend, modify, supplement, acknowledge and deliver any and all contracts, agreements ... or other instruments necessary, proper or desirable to carry out the business of the Company.

Operating Agreement, § 9(f).

The Amended Operating Agreement replaced section 9(i) of the Operating Agreement, providing, in pertinent part, as follows:

> Section 9(i) of the LLC Agreement shall be deleted in its entirety and replaced with the following:
>
> "(i) Major Decisions. ... the Operations Manager shall not, and no Member shall, without obtaining the Consent of the Managing Members, have the right, power or authority to do or take, or to permit or cause the Company or Project Owner to do or take, any of the following:
>
> (a) make expenditures on behalf of the Company or cause Project Owner to make expenditures which are not provided for in the Approved Operations Budget and which exceed, in the aggregate, 5.0% of the total Approved Operations Budget in any Fiscal Year, or with respect to any Individual Budget, exceed the lesser of (1) 5.0% of such Individual Budget, and (2) $250,000; provided, however, that the Operations Manager shall be permitted to incur Emergency Expenses; ... ."

Id., § 2(b). Based upon this plain contract language, plaintiffs' unanimous consent was not required under the Amended Operating Agreement. Moreover, the re-shuffling of loans was not an expenditure that would trigger section 9(i), as amended, as is argued by plaintiffs. Amended Complaint, ¶¶ 82-84. "By definition a loan is 'something lent or furnished *on condition of being returned*, esp[ecially] a sum of money lent at interest.'" *Technicorp Intl. II, Inc. v Johnston*, 1997 WL 538671, *21 (Del Ch 1997) (emphasis in original). An expenditure, as defined by Merriam-Webster's Dictionary, is an expense or disbursement. *See http://www.merriam-webster.com/dictionary/expenditure.* If anything, the re-shuffling represented funds coming into the Company and the entities financing the project, not the disbursement of funds from the Company. Nothing contained in the pleading supports plaintiffs' allegation that the "re-shuffling transaction constituted an expenditure." Amended Complaint, ¶ 84. Nor does the Court find any support for this allegation in the case law.

Plaintiffs argue that the parties never intended to delete the "Unanimous Decisions" provision in section 9(i)(ii) of the Operating Agreement, attributing the deletion to a scrivener's error. "Where there is no mistake about the agreement and the only mistake alleged is in the reduction of the agreement to writing,

such mistake of the scrivener, or of either party, no matter how it occurred, may be corrected." *Nash v Kornblum*, 12 NY2d 42, 47 (1962) (quotation marks and citation omitted). Here, none of plaintiffs' allegations or evidence support the conclusion that the parties "agree[d] among themselves with respect to the meaning of the disputed language" (*Stonebridge Capital, LLC v Nomura Intl. PLC*, 68 AD3d 546, 548 [1st Dept 2009], *lv dism* 15 NY3d 735 [2010], or that there was any kind of mutual mistake, *Resort Sports Network Inc. v PH Ventures III, LLC*, 67 AD3d 132, 136 (1st Dept 2009). To the contrary, while plaintiffs attribute the deletion of section 9(i)(ii), in its entirety, to a scrivener's error, defendants hold fast to their argument that the clear and unambiguous language of the Amended Operating Agreement "leaves no room for interpretation," and "could not be more clear," in replacing section 9(i) in its entirety. SE Defendants' Reply Brief, at 4. This is not "a case like *Nash v Kornblum* (12 NY2d 42 [1962]), where the agreement of the parties was ascertainable by reference to a single immutable fact (calculation of linear feet on subject property) that was the substance of the agreement." *Resort Sports Network Inc.*, 67 AD3d at 136.

At most, plaintiffs' argument evidences their own unilateral mistake, which "is not enough to rewrite an agreement that is complete on its face [and] unambiguous." *Resort Sports Network*, 67

AD3d at 136. Plaintiffs concede that it was a "blackline of the agreement ..., proffered by [the] office" of plaintiffs' counsel, that "reflect[ed] a deletion of Section 9(i)(ii)." Goldberg Aff., ¶ 8. However, plaintiffs "cannot secure reformation by merely showing that their attorney made what appears to be a unilateral mistake. In the absence of actual fraud, the mistake shown must be one made by both parties, so that, demonstrably, the intentions of neither are expressed in it." *Stonebridge Capital, LLC v Nomura Intl. PLC*, 24 Misc 3d 1218(A), *5, (Sup Ct, NY County 2009), *affd* 68 AD3d 546 (1st Dept 2009). Moreover, the Operating and Amended Operating Agreements contained integration and merger clauses, and "the parties were sophisticated business entities represented by counsel." *Resort Sports Network*, 67 AD3d at 136; *see also New York First Ave. CVS v Wellington Tower Assoc.*, 299 AD2d 205, 206 (1st Dept 2002), *lv den* 100 NY2d 505 (2003) ("[w]hile plaintiff points to an apparently missing paragraph in the lease, the general merger clause precludes plaintiff from arguing that the executed lease does not contain the full agreement of the parties"). Thus, plaintiffs "fail[] to meet the 'heavy presumption that a deliberately prepared and executed written instrument manifest[s] the true intention of the parties.'" *Stonebridge Capital*, 68 AD3d at 548 (citation omitted). For the foregoing reasons, plaintiffs' claims concerning the impropriety of the loan re-shuffling are dismissed.

B. Forbearance and Modification Agreements

For the same reasons, under the Amended Operating Agreement, plaintiffs' consent was not required in order for the SE Defendants to enter into the Forbearance and Modification Agreements (Amended Complaint, ¶¶ 111-130), to the extent 57th Owner LLC allegedly failed to remit to Wells Fargo certain net proceeds from condominium sales and to the extent Wells Fargo held condominium sales proceeds instead of applying those proceeds to outstanding loan debt. However, plaintiffs allege that the Modification and Forbearance Agreements required payment of a $5,161,371 Modification Fee and a Special Payment totaling $3,447,527.53. Amended Complaint, ¶¶ 116, 123. These alleged expenditures may have required plaintiffs' consent under section 9(i)(i)(a) of the Amended Operating Agreement, because they clearly exceeded $250,000. Moreover, while the SE Defendants argue that they entered into these agreements in good faith, as sound business decisions, whether these alleged expenditures constituted "Emergency Expenses" under this provision of the Operating Agreement (Operating Agreement, Schedule A - Definitions at A-5), or acts "performed ... in good faith on behalf of the Company and in a manner reasonably believed to be within the scope of the authority conferred" (Operating Agreement, § 26[a]), require factual determinations as to reasonableness and good faith, neither of which are appropriately addressed on a pre-answer motion to

dismiss. Therefore, the SE Defendants' motion to dismiss plaintiffs' allegations, concerning the impropriety of the Forbearance and Modification Agreements, is denied.

C. Misappropriation by Falcon

Plaintiffs' next set of allegations is that Swig hired Falcon - an entity allegedly owned by Swig but with no construction expertise or relationships with tradesmen or suppliers - to misappropriate Building Loan proceeds. Amended Complaint, ¶¶ 91-101. Both the Operating and Amended Operating Agreements provided for the payment of a "Construction Management Payment," which the Operating Agreement defined as "the payment to be made by the Project Owner to the Construction Manager for the supervision, management and construction of the Project." Operating Agreement, Schedule A, at A-3 - A-4. This payment was to be "an amount equal to two percent (2%) of the Construction budget plus four percent (4%) of hard costs for general conditions; provided that the total Project fees for general conditions shall not exceed eight percent (8%)." *Id.* at A-4.

The Operating Agreement expressly stated that "'Construction Manager' means Falcon Pacific Construction, LLC." *Id.* at A-4. Moreover, the Construction Management Agreement, entered into between Falcon and 57th Owner LLC in July 2006 provides that Falcon,

[* 29]

as Construction Manager, "will arrange to provide through subcontractors and independent contractors contracting directly with [Falcon] all labor, materials and services for the renovation of the Project ... ." § 2.2. To this end, Swig retained Pinnacle to perform the necessary construction work. Plaintiffs claim that Falcon received over $6 million for general conditions and fees, drawn from the Senior Building Loan proceeds, and that total fees for general conditions exceeded $10 million, thereby exceeding the 8% maximum.

In support of their motion to dismiss, the SE Defendants submit the May 30, 2008 "Independent Accountants' Report On Applying Agreed-Upon Procedures," prepared by the accounting firm, Eisner & Lubin LLP ("Eisner Report"). The Eisner Report analyzed Falcon's construction management fees for the period May 1, 2006 through February 29, 2008, purportedly "in accordance with attestation standards established by the American Institute of Certified Public Accountants," and Eisner & Lubin LLP considered the Operating and Amended Operating Agreements and the agreements between Falcon and Pinnacle.

The Eisner Report was also based upon requisitions from Pinnacle to Falcon, from Falcon to the Company, and from the Company to KeyCorp, and disbursements back down the chain to

Pinnacle. The Report concluded that "Total Project cost[s]" were $95,451,346, that Falcon's total fees billed as of February 29, 2008 were $4,908,933, and that Falcon's total fees calculated as of this date were $5,037,057, leaving an amount due to Falcon of $128,124. *Id.* at 5. Thus, according to the Eisner Report, the total fees calculated for Falcon - $5,037,057 of the $95,451,346 total costs - are within the 8% maximum, as were the total fees billed of $4,908,933.

However, the Eisner Report also stated, in pertinent part, as follows:

> During the comparison of the AIA requisitions from Pinnacle to the schedule of costs by requisition, we noted that several of the requisitions contained a line with the designation General Conditions. Since neither of the contracts give Pinnacle a general conditions fee (except as noted above for change orders during Phase II), we questioned the staff of Falcon and were informed that the contracts made by Falcon are for the amounts indicated and the division between line items is left to Pinnacle and Falcon's review as the project manager.

Id. at 2. Consistent with this representation in the Eisner Report, the documentary evidence of Pinnacle invoices, submitted by plaintiffs, shows that Pinnacle included a line item for "General Conditions Fee (10%)," and also a separate 5% fee for "Overhead, Profit & Insurance." Thus, on the one hand, Falcon may have paid Pinnacle fixed fees under their contracts, as is argued by the SE

Defendants, and then Pinnacle independently characterized or allocated amounts owed, for its own internal accounting purposes, as general conditions.[6] On the other hand, Falcon may have paid general conditions fees to Pinnacle, and then charged additional Construction Management Fees, including additional general conditions, for itself, thereby duplicating fees and exceeding the 8% cap. Thus, the Eisner Report does not "utterly refute" plaintiffs' allegation that total fees for general conditions exceeded the contractual 8% maximum, "conclusively establishing a defense as a matter of law" (*Goshen v Mutual Life Ins. Co. of N.Y.*, 98 NY2d 314, 326 [2002]), but rather, the Report raises a factual issue as to whether the item identified by Pinnacle as "General Conditions" is the same general conditions contained in the Operating Agreement that relates to the Construction Management Payment. Therefore, the SE Defendants' motion to dismiss these allegations is denied.

D. Misappropriation of Loan Proceeds

The SE Defendants next seek dismissal of plaintiffs' allegations that the SE Defendants misappropriated loan proceeds (*e.g.*, Amended Complaint, ¶ 98), claiming that they provided complete financial transparency to plaintiffs. In support of this

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[6] Pinnacle submits no papers in connection with this motion.

argument, the SE Defendants submit e-mails to plaintiffs, with attachments of status reports, activity reports, vender invoices, closing statements, condominium sales data, and contract summaries. Swig Aff., Exs. 6 and 7. However, this documentary evidence merely raises factual issues as to the extent of information available to plaintiffs, without resolving the claimed misappropriation.

Moreover, "[i]n order for evidence to qualify as 'documentary,' it must be unambiguous, authentic, and undeniable. Neither affidavits, deposition testimony, nor letters are considered 'documentary evidence' within the intendment of CPLR 3211 (a) (1)." *Granada Condominium III Assn. v Palomino*, 78 AD3d 996, 996-97 (2d Dept 2010) (internal citation omitted). Thus, to the extent that the SE Defendants rely upon Swig's explanations of the alleged misappropriations as legitimate business expenditures, his affidavit merely "assert[s] the inaccuracy of plaintiffs' allegations," and, therefore, the affidavit "may not be considered, in the context of [the] motion to dismiss, for the purpose of determining whether there is evidentiary support for the complaint." *Tsimerman v Janoff*, 40 AD3d 242, 242 (1st Dept 2007). Accordingly, the SE Defendants' motion to dismiss these misappropriation allegations is denied.

E. Exclusive Sales Agency Agreement

The SE Defendants also seek dismissal of plaintiffs' allegations concerning the unauthorized Exclusive Sales Agency

Agreement (the "Sales Agreement") and the failure to pay commissions. Amended Complaint, ¶¶ 159-163. The SE Defendants argue that plaintiffs consented to the Sales Agreement and were not entitled to sales commissions until they repaid outstanding loans. Section 2(b) of the Amended Operating Agreement provides that "each of the Managing Members shall not unreasonably withhold, condition or delay its consent, and any such consent shall be deemed granted if such Managing Member has not denied such consent by notice to the Operations Manager within ten (10) Business Days after the Operations Manager delivered a written request for consent." By e-mail dated September 6, 2006, Swig Equities sent a draft of the Sales Agreement to Levy and Hoyda (the principals of YL and SH). The e-mail stated as follows: "Attached please find the draft Sales Agency Agreement with respect to the Sheffield. Please note that Kent has not reviewed the attached and, thus, it remains subject to his review. Please feel free to call me with any questions." Swig Aff., Ex. 15. According to Swig, SH never objected to this e-mail, and YL objected on September 26, 2006, more than 10 days after the e-mail was sent. Swig Aff. at 22, n 7.

Plaintiffs do not deny that SH failed to object, but instead argue that the e-mail did not specifically request consent and attached only a draft of the Sales Agreement. However, the Amended Operating Agreement did not require any particular language to be

used in requesting consent. Moreover, the e-mail was in writing and clearly apprised plaintiffs of 57th Owner LLC's intention to enter into the Sales Agreement with Swig Equities, thereby complying with the notice requirement of the Amended Operating Agreement. SH's failure to object within 10 business days would constitute consent which, together with the consent of SE Management, would constitute majority consent. However, the only evidence of SH's failure to object is contained in Swig's affidavit, which raises a factual issue that cannot be resolved at this juncture. *Tsimerman*, 40 AD3d at 242; *Granada Condominium III Assn.*, 78 AD3d at 996-97. Therefore, to the extent that the SE Defendants seek dismissal of plaintiffs' claim that the Sales Agreement was unauthorized, their motion is denied.

With respect to outstanding member loans, the Sales Agreement provided for distribution of commissions in the following order: "*first* to pay any expenses incurred under this Agreement, *second* to any Member Loan (as defined in [the Amended Operating Agreement]) and *third* to Owner [57th Owner LLC], which shall distribute such funds in accordance with Owner's individual member's percentage interest of ownership." Sales Agreement, § 5(a). Section 9(i)(c) of the Amended Operating Agreement confirmed that "each Managing Member[]" was to receive a share of sales commissions consistent with each member's "Percentage Interest of any sales." Section

25(a) of the Operating Agreement defined "Member Loan" as shortfalls resulting from a member declining to make additional capital contributions to the Company in amounts consistent with that member's percentage interest in the additional funds, and section 25(c) provided that Member Loans are payable "solely out of any distributions of Available Cash Flow that would otherwise thereafter be payable." Thus, under the parties' agreements, outstanding Member Loans could preclude distribution of commissions under the Sales Agreement.

Plaintiffs do not expressly object to the SE Defendants' assertion that there are, or were, outstanding Member Loans. However, in support of their argument that "there are Member Loans that indisputably remain unpaid," the SE Defendants rely solely upon Swig's affidavit (Swig Aff., ¶ 83), which merely raises factual issues as to the existence and amount of any purported outstanding Member Loans, and any funds available for distribution to "Owner" under the "*third*" category of distribution under the Sales Agreement. *Tsimerman*, 40 AD3d at 242; *Granada Condominium III Assn.*, 78 AD3d at 996-97. Swig's affidavit cannot convert the SE Defendants' motion to dismiss into a motion for summary judgment. Rather, the SE Defendants were required to come forward with documentary evidence establishing the existence of the alleged Member Loans in order to conclusively establish a defense as a

matter of law, which they failed to do. Therefore, at this juncture, the SE Defendants' motion to dismiss plaintiffs' claim, to the extent based upon the SE Defendants' alleged failure to distribute commissions to 57th Owner LLC, is denied.

F. Condominium Reserve Fund

The SE Defendants next seek dismissal of plaintiffs' allegations that Swig caused 57th Owner LLC to apply reserve funds to pay unrelated legal fees and tax escrow shortages. Amended Complaint, ¶¶ 164-167. The SE Defendants concede that 57th Owner LLC borrowed from the reserve fund, but claims that: it did so relying upon the advice of the Company's counsel, as permitted under section 26(d) of the Operating Agreement; the borrowed funds were used exclusively for the benefit of the project; 57th Owner LLC executed promissory notes for the withdrawals; and 75% of the borrowed funds have been repaid. Swig Aff., ¶ 85. As documentary evidence, the SE Defendants submit a copy of a Promissory Note evidencing a $300,000 debt owed by 322 West 57th Street Condominium, as "Borrower," to Falcon. Plaintiffs do not dispute the validity or enforceability of the Promissory Note. Nor do they cite any legal authority for the proposition that such sponsor loans are improper. Therefore, plaintiffs' allegations of misuse of the condominium's reserve funds are dismissed.

G. Condominium Common Charges

With respect to plaintiffs' claim that the Company failed to pay common charges for unsold condominium units (Amended Complaint, ¶¶ 168-171), the SE Defendants concede that 57th Owner LLC ran out of funds to pay for these charges. The SE Defendants claim that 57th Owner LLC acknowledged its responsibility to pay these charges and agreed to pay them as part of the Settlement in the Wagner Proceeding, *supra*. Indeed, the Wagner Proceeding was discontinued with prejudice and the petition dismissed, by decision and order dated June 4, 2009 (Sherwood, J.) and in accordance with a so-ordered stipulation pursuant to which 57th Owner LLC expressly agreed to pay the Board of Managers of the 322 West 57th Street Condominium "all common charges due and owing by the Sponsor to the Board of Managers for or attributable to the Sponsor Units," prior to the closing of specified sales or refinancing transactions. Swig maintains that the outstanding "common charges have now, in all material respects, been paid in full (subject only to confirming invoices and accounting adjustments)." Swig Aff., ¶ 86. Plaintiffs do not respond to this argument.

Plaintiffs also claim that the Wagner Proceeding was settled without their consent, in violation of section 9(i)(b) of the Amended Operating Agreement. Amended Complaint, ¶ 171. The SE Defendants seek dismissal of this allegation, arguing that the

settlement imposed no greater liability on the sponsor for common charges than it already had. While this argument does not negate the alleged breach, it undermines plaintiffs' claim for damages. Because 57th Owner LLC has expressly represented its obligation to pay common charges and settled the proceeding concerning those charges, plaintiffs' allegations concerning nonpayment of common charges, and unauthorized settlement of that proceeding, are dismissed.

H. Duplicative Claims

The SE Defendants argue that plaintiffs' claims for breach of fiduciary duty should be dismissed as duplicative of the cause of action for breach of contract. Indeed, ordinarily, the violation of a contractual right does not amount to a breach of fiduciary duty. *Albert v Alex. Brown Mgt. Servs.*, 2005 WL 2130607, *4, 2005 Del Ch LEXIS 133 (Del Ch 2005); *see also Pollak v Moore*, 85 AD3d 578, 579 (1st Dept 2011) ("claims sounding in breach of fiduciary duty" dismissed as "duplicative of [plaintiff's] breach of contract claims"). However, under both Delaware and New York law, "[c]onduct by an entity that occupies a fiduciary position ... may form the basis of both a contract and a breach of fiduciary duty claim," under certain circumstances. *RJ Assoc. v Health Payors' Org. Ltd. Partnership*, 1999 WL 550350, *10, 1999 Del Ch LEXIS 161, *34 (Del Ch 1999); *Mandelblatt v Devon Stores*, 132 AD2d 162, 167-168 (1st Dept 1987) ("the same conduct which may constitute the

breach of a contractual obligation may also constitute the breach of a duty arising out of the relationship created by contract but which is independent of the contract itself").

At this stage in the litigation, plaintiffs may state their causes of action in the alternative or hypothetically. CPLR 3014. While many of plaintiffs' allegations of breach of fiduciary duty may be linked to the various agreements among the parties, taken together, plaintiffs' first and second causes of action are based upon a pattern of improper conduct designed to misappropriate funds that were to be used for the development of the Property. The relevant agreements - and the SE Defendants' alleged violations thereof - may have been used by defendants to carry out the overarching misappropriation of funds, thereby constituting independent breaches of fiduciary duties. Moreover, although Swig is alleged to be a direct or indirect owner of various defendant entities in this action, Swig, in his individual capacity, is not a party to many of the relevant agreements, such as the Operating Agreement, the Amended Operating Agreement, the Construction Management Agreement, the Amended and Restated Building Loan Agreement, the mezzanine loans agreements, or the Sales Agreement, and plaintiffs' fourth cause of action for breach of contract is not asserted against Swig. Accordingly, the SE Defendants' motion

to dismiss the breach of fiduciary duty causes of action as duplicative of the breach of contract claim is denied.

For the foregoing reasons, the SE Defendants' motion to dismiss the first and second causes of action is granted to the limited extent described above, and the motion is otherwise denied.

II. Breach of Contract against SE Management and SE Property (4th Cause of Action)

The SE Defendants next seek dismissal of the fourth cause of action for breach of contract. For the reasons discussed above, the motion is granted to the extent based upon the SE Defendants' unauthorized refinancing of loans; entering into Forbearance and Modification Agreements without plaintiffs' consent; and the hiring of Falcon and Falcon's hiring of nonparty Pinnacle Contractors of NY, Inc.

Plaintiffs also claim that Swig committed various additional breaches of the Operating Agreement, which required the Managing Members to cause the Company to: "maintain an arm's length relationship with its Affiliates and the Members" (Operating Agreement, § 9[j][ii][H]), "not hold out its credit or assets as being available to satisfy the obligations of others" (*id.*, § 9[j][ii][J]), "to the extent of Available Cash Flow, maintain adequate capital in light of its contemplated business purpose,

transactions and liabilities" (*id.*, § 9[j][ii][O]), and "cause the Managing Members, agents and other representatives of the Company to act at all times with respect to the Company consistently and in furtherance of the foregoing and in the best interests of the Company" (*id.*, § 9[j][ii][R]). Amended Complaint, ¶ 172. SE Management and SE Property allegedly breached each of these provisions, including the commingling of 57th Owner LLC's funds with Swig's other entities and causing the Company to divert funds from 57th Owner LLC to Swig-controlled entities. In addition, SE Property and SE Management allegedly refused to provide plaintiffs and the Company's accountants with the Company's books and records, in violation of section 20 of the Operating Agreement; and discounted and raised residential sales prices by more than 6% without plaintiffs' consent, in violation of section 9(i)(f) of the Amended Operating Agreement. Amended Complaint, ¶¶ 177, 178. SE Management and SE Property seek dismissal of these additional claims of breach of contract.

Plaintiffs fail to allege which entities commingled funds, or how such commingling violated section 9(j)(ii)(H) of the Operating Agreement. Amended Complaint, ¶¶ 172-173. Nor do plaintiffs name any unrelated entities whose funds were commingled with the funds of 57th Owner LLC. *Id.* Plaintiffs fail to assert anything more than a conclusory allegation concerning the diversion of funds from

57th Owner LLC, in violation of 9(j)(ii)(J). *Id.*, ¶ 174. Moreover, the claimed violation based upon refusal to provide access to books and records fails, because plaintiffs fail to allege that they demanded such access, "in writing and ... stat[ing] the purpose of such demand." 6 Del C § 18-305(e)[7]; *see also RJ Assoc.*, 1999 WL 550350, *11, 1999 Del Ch LEXIS 161, *41 (dismissing books and records claim under analogous provision of Delaware's limited partnership law, based upon the plaintiff's failure to allege a written demand in the complaint). Plaintiffs' claimed violation of section 9(j)(ii)(O) is based on their general and conclusory allegation that SE Management and SE Property failed to cause 57th Owner LLC to maintain adequate capital. Amended Complaint, ¶ 175. The maintenance of adequate capital in section 9(j)(ii)(O) is contingent upon "the extent of Available Cash Flow," and plaintiffs fail to allege the existence of Available Cash Flow to substantiate their claim, as opposed to defendants' wrongdoing.[8] Accordingly,

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[7] Section 18-305 is expressly identified in section 20 of the Operating Agreement.

[8] The Court notes that this claim is also undermined, albeit indirectly, by plaintiffs' own allegations that the increased construction budget called for $12 million in new equity contributions, "which Plaintiffs insisted Swig advance." *Id.*, ¶ 1. Plaintiffs do not claim that they ever attempted to fund additional equity contributions, or assist the Company to maintain adequate capital. Swig, on the other hand, submits documentary evidence showing that, in July 2007, SE Management obtained plaintiffs' consent to obtain an additional loan of approximately $21 million. Swig Aff., Ex. 8.

the fourth cause of action is dismissed with respect to these breaches.

Plaintiffs' claim that these defendants failed to act in the best interests of the Company and 57th Owner LLC, in violation of section 9(j)(ii)(R), is based upon, "among other things, ... the conduct described herein," referring to the Amended Complaint, ¶ 176. To the extent that plaintiffs' breach of fiduciary duty claims survive against SE Management and SE Property, they may also give rise to breaches of section 9(j)(ii)(R). Therefore, the motion to dismiss this portion of the fourth cause of action is denied.

Plaintiffs' claim concerning residential sales prices is based upon section 9(i)(f) of the Amended Operating Agreement, which requires consent in order to "set[] the sale prices of the residential Condominium units or, after the sale prices have been set with the Consent of the Managing Members, amend[] the residential sale prices by more than 6%." In support of their motion to dismiss, the SE Defendants submit the same documentary evidence relied upon with respect to plaintiffs' claim for misappropriation of loan proceeds, namely, e-mails to plaintiffs, with attachments of status reports, activity reports, vender invoices, closing statements, condominium sales data, and contract

summaries. Swig Aff., Exs. 6 and 7. The SE Defendants argue that plaintiffs consented to any changes in prices, based upon their failure to object to these documents. While these documents clearly show "PRICE AS PER 18TH AMENDMENT," "MINIMUM RELEASE PRICE," and "PURCHASE PRICE," it is not clear to the Court that amended sales prices were disclosed to plaintiffs prior to selling the units. In other words, based upon the documentary evidence submitted, it is possible that defendants amended sales prices, sold units with amended prices that exceeded the 6% cap in section 9(i)(f), and then notified plaintiffs afterwards. Accordingly, the documentary evidence does not "utterly refute" plaintiffs' allegation, and the motion to dismiss this portion of plaintiffs' fourth cause of action is denied.

III. Money Had and Received (5th and 12th Causes of Action)

These derivative causes of action are asserted against the SE Defendants (in the fifth cause of action) and Swig Equities (in the twelfth cause of action), essentially claiming these defendants received and benefitted from the loan proceeds and sales commissions, both of which belonged to the plaintiffs. The equitable claim of money had and received is a quasi-contractual claim. "The elements of a claim for money had and received are: (1) defendant received money belonging to plaintiff; (2) defendant benefitted from the receipt of the money; and (3) under principles

of good conscience, defendant should not be allowed to retain the money." *Fesseha v TD Waterhouse Inv. Servs.*, 193 Misc 2d 253, 260 (Sup Ct, NY County 2002), *affd* 305 AD2d 268 (1st Dept 2003). However, "[a]n action for money had and received does not lie where there is an express contract between the parties." *Egnotovich v Katten Muchin Zavis & Roseman LLP*, 55 AD3d 462, 464 (1st Dept 2008); *Street Search Partners., L.P. v Ricon Intl.*, 2005 WL 1953094, *1, 2005 Del Super LEXIS 246, *4 (Del Super 2005) ("'money had and received' is an ancient cause of action subsumed by modern law regarding breach of contract," and the claim can "be made only against a party in privity ..., and not against third parties who did not receive money from the plaintiff").[9]

As discussed above, plaintiffs do not have standing to bring derivative claims on behalf of 57th Owner LLC. The remainder of the claim, asserted derivatively on behalf of the Company and the mezzanine borrowers, is barred by the Operating Agreement as asserted against SE Management and SE Property. *Egnotovich*, 55 AD3d at 464. However, the claim is not barred against Swig, in his individual capacity, because he was not a party to any of the

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[9] Because of the court's conclusion in *Street Search Partners*, that "'[m]oney had and received' is no longer a legally cognizable claim," it is questionable whether Delaware courts will recognize the cause of action at all. 2005 WL 1953094, *4, 2005 Del Super LEXIS 246, *14.

relevant agreements. Nor is the claim barred against Falcon or Swig Equities, as neither party had a contractual relationship with the Company. Rather, Falcon entered into the Construction Management Agreement with 57th Owner LLC, and the Sales Agreement was between Swig Equities and 57th Owner LLC. Swig allegedly controlled both Falcon and Swig Equities, and improperly used these entities to obtain funds that rightfully belonged to the Company.

The SE Defendants argue that the Operating Agreement bars the money had and received claims, because 57th Owner LLC was an intended third-party beneficiary of that Agreement. The SE Defendants highlight the fact that plaintiffs are simultaneously asserting the corporate waste claim against Falcon based upon breaches of the Operating Agreement. However, the SE Defendants have not conclusively established that Falcon, although defined as "Construction Manager" in the Operating Agreement, is a third-party beneficiary of the Operating Agreement. Moreover, as discussed above, the corporate waste claim is dismissed against Falcon, thereby undermining the SE Defendants' argument that the Operating Agreement bars the claim against Falcon.

The SE Defendants also argue that the money had and received claim fails against Swig Equities, because plaintiffs "fail[] to allege a specific, segregable fund which makes the monies

equivalent to chattels and the claim is governed by Section 9 of the [Operating Agreement] and the Sales Agreement, which governs payment of commissions." SE Defendants' Mem. of Law in Support, at 18-19. The SE Defendants fail to explain how an allegation of "specific, segregable fund[s]" are relevant to either Agreement, or the specific provisions of the Operating and Sales Agreement that are implicated. Therefore, this argument is unpersuasive.

Plaintiffs allege that Swig, Falcon and Swig Equities received the benefit of the loan proceeds and sales commissions that rightfully belonged to plaintiffs. Therefore, at this juncture, plaintiffs have stated a cause of action for money had and received against these defendants. The SE Defendants' motion to dismiss this claim is granted to the extent asserted against SE Management and SE Property.

IV. Conversion (6th Cause of Action)

Plaintiffs' sixth cause of action asserts a derivative claim for conversion against the SE Defendants, claiming that these defendants improperly took funds that belonged to plaintiffs and exercised unauthorized dominion over those funds.

> A conversion takes place when someone, intentionally and without authority, assumes or exercises control over personal property belonging to someone else, interfering with that person's right of possession. Two key elements of conversion are (1) plaintiff's

> possessory right or interest in the property and (2) defendant's dominion over the property or interference with it, in derogation of plaintiff's rights.

Colavito v New York Organ Donor Network, Inc., 8 NY3d 43, 49-50 (2006) (internal citations omitted).

A claim for conversion of money must involve "a specific, identifiable fund and an obligation to return or otherwise treat in a particular manner the specific fund in question." *Manufacturers Hanover Trust Co. v Chemical Bank*, 160 AD2d 113, 124 (1st Dept 1990), *app den* 77 NY2d 803 (1991); *accord Goodrich v E.F. Hutton Group, Inc.*, 542 A2d 1200, 1203 (Del Ch 1988) ("[m]oney is subject to conversion only when it can be described or identified as a specific chattel"). Thus, "[m]oney, specifically identifiable and segregated, can be the subject of a conversion action." *Manufacturers Hanover Trust Co.*, 160 AD2d at 124. However, a cause of action for conversion of money is subject to dismissal where the money is alleged to have been paid into the business entity's general account and commingled with the business entity's other funds. *Auguston v Spry*, 282 AD2d 489, 491 (2d Dept 2001) (conversion claim dismissed where "money was to be commingled into the corporation's capital. As commingled money, his money was incapable of being converted").

Here, plaintiffs allege, only generally, that the SE Defendants misdirected funds distributed by the lenders. Their allegations fail to identify the specific funds improperly transferred from the Company and where the funds were transferred. Thus, plaintiffs fail to allege a specific, identifiable fund. Moreover, to the extent that the SE Defendants received funds allegedly belonging to the Company, plaintiffs do not dispute that those funds were commingled in these defendants' accounts, making it impossible for the funds to be specifically identifiable to support the conversion cause of action. Accordingly, the SE Defendants' motion to dismiss the sixth cause of action is granted.

V. Accounting (14th Cause of Action)

The SE Defendants argue that plaintiffs' fourteenth cause of action for an accounting should be dismissed, because plaintiffs have an adequate remedy at law and because of plaintiffs' unclean hands. Here, plaintiffs allege the existence of a fiduciary relationship, which gives rise to "an absolute right to an accounting notwithstanding the existence of an adequate remedy at law." *Koppel v Wien, Lane & Malkin*, 125 AD2d 230, 234 (1st Dept 1986); *Technicorp Intl. II, Inc. v Johnston*, 2000 WL 713750, *16, 2000 Del Ch LEXIS 81 (Del Ch 2000).

Defendants' unclean hands defense is based upon YL and Levy allegedly attempting to convert two vacant apartments from the Project for personal use, and Levy's guilty plea to a charge of harassment in the second degree based upon an altercation with Swig. Defendants' claim of conversion of apartments is not supported by documentary evidence and, therefore, not subject to dismissal at this juncture. None of the cases cited by defendants support their unclean hands argument with respect to Levy's guilty plea. The SE Defendants fail to show that Levy's conduct was "'directly related to the subject matter in litigation [citations omitted].'" *National Distillers & Chem. Corp. v Seyopp Corp.*, 17 NY2d 12, 15-16 (1966). Nor do defendants offer any reason why the accounting cause of action should be barred as asserted by SH. For these reasons, the SE Defendants' motion to dismiss plaintiffs' accounting cause of action is denied.

Wells Fargo and KeyCorp (Motion Sequence No. 009)

I. Aiding and Abetting Breach of Fiduciary Duty (3rd Cause of Action)

Wells Fargo and KeyCorp argue that plaintiffs lack standing to assert the direct claim of aiding and abetting breach of fiduciary duty (the third cause of action), because this claim is derivative in nature. They argue that plaintiffs would lack standing even if the claim were amended to assert it derivatively, because plaintiffs lost their interest in the Company when the 434 Entities

foreclosed on plaintiffs' ownership interest. Plaintiffs do not seriously dispute that the third cause of action is derivative. Instead, citing title 6, section 18-1002 of the Delaware Code, plaintiffs argue that they have standing to assert the claim derivatively, because they were members of 57th Owner LLC at the time this action was commenced and at the time of the loan transactions at issue in the Amended Complaint.

Under Delaware law, in order to determine whether plaintiffs' claims are derivative or individual, the

> court should look to the nature of the wrong and to whom the relief should go. The stockholder's claimed direct injury must be independent of any alleged injury to the corporation. The stockholder must demonstrate that the duty breached was owed to the stockholder and that he or she can prevail without showing an injury to the corporation.

Tooley v Donaldson, Lufkin, & Jenrette, Inc., 845 A2d 1031, 1039 (Del Supr 2004). Under *Tooley*, "[t]he analysis must be based solely on ... : Who suffered the alleged harm - the corporation or the suing stockholder individually - and who would receive the benefit of the recovery or other remedy[.]" *Id.* at 1035.

Here, plaintiffs have alleged facts showing injury vis-á-vis their ownership interests in the Company. However, the individual

claim fails to allege any harm independent from the alleged injury suffered by the Company. Simply put, plaintiffs cannot prevail on this cause of action without showing an injury to the Company. Therefore, the third cause of action is a derivative in nature and must be dismissed, as it is improperly asserted as a direct claim.

The Court notes plaintiffs' argument, in their opposition brief, that they are "entitled to re-plead a derivative claim for aiding and abetting breach of fiduciary duty, if the Court deems it necessary." Plaintiffs' Mem. in Opp. at 24. Plaintiffs neither cross-move for leave to amend nor submit an amended pleading. In addition, plaintiffs fail to articulate how any proposed amendment would properly assert a derivative claim for aiding and abetting breach of fiduciary duty against Wells Fargo or KeyCorp. Therefore, there is no proper request for leave to amend presently before the Court.

In any event, the third cause of action is subject to dismissal for failure to allege substantial assistance. "A claim for aiding and abetting a breach of fiduciary duty requires: (1) a breach by a fiduciary of obligations to another, (2) that the defendant knowingly induced or participated in the breach, and (3) that plaintiff suffered damage as a result of the breach." *Kaufman v Cohen*, 307 AD2d 113, 125 (1st Dept 2003); *In re Transkaryotic*

Therapies, Inc., 954 A2d 346, 370 (Del Ch 2008) (same).[10] The element of knowing participation requires "an allegation that such defendant had actual knowledge of the breach of duty." *Kaufman*, 307 AD2d at 125; *Gatz v Ponsoldt*, 925 A2d 1265, 1276 (Del Supr 2007) ("'[k]nowing participation in a ... fiduciary breach requires that the third party act with the knowledge that the conduct advocated or assisted constitutes such a breach'"). "A person knowingly participates in a breach of fiduciary duty only when he or she provides 'substantial assistance' to the primary violator," which "occurs when a defendant affirmatively assists, helps conceal or fails to act when required to do so, thereby enabling the breach to occur." *Kaufman*, 307 AD2d at 126.

Here, the substantial assistance alleged by plaintiffs is based upon their assertion that Wells Fargo and KeyCorp "improperly advanc[ed] the Senior Building Loan's funds to a grossly out of balance loan with knowledge thereof," and "enter[ed] into transactions with the Company's affiliates that they knew were not authorized." Amended Complaint, ¶ 203. However, plaintiffs fail to allege that Wells Fargo and KeyCorp had a duty *not* to advance funds under the Senior Building Loan, either by contract or

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[10] "Where no conflict exists between the laws of the jurisdictions involved, there is no reason to engage in a choice of law analysis." *Elson v Defren*, 283 AD2d 109, 114 (1st Dept 2001).

otherwise. In fact, Section 2.1.10 of the Amended and Restated Building Loan Agreement afforded "Lender ... the right (*but not the obligation*) to notify Borrower that, in Lender's sole but reasonable judgment ..., the cost of all Total Project-Related Costs that remain unpaid at the time in question exceeds the undisbursed proceeds of the Loan ... ." (emphasis added). Thus, the Amended and Restated Building Loan Agreement itself contemplated that it could become "out of balance," as is alleged by plaintiffs.

Moreover, the Amended and Restated Building Loan Agreement imposed conditions precedent - such as hiring of the Construction Consultant, as described above - that, once satisfied, created "obligations of the Lender" to make advances. *Id.*, § 2.9.3. Plaintiffs fail to identify anything that *prohibited* advances if those same conditions were not satisfied. Plaintiffs also claim that they "reasonably relied on the Senior Lender to monitor the administration of Senior Building Loan proceeds." Amended Complaint, ¶ 106. Their claimed reliance is undermined by the "No Reliance" provision contained in the Amended and Restated Building Loan Agreement, which provided that:

> All conditions and requirements of this Agreement are for the sole benefit of Lender and no other person or party ... shall have the right to rely on the satisfaction of such

> conditions and requirements by Borrower. Lender shall have the right, in its sole and absolute discretion, to waive any such condition or requirement.

Id., § 2.9.5. Accordingly, the Amended and Restated Building Loan Agreement refutes plaintiffs' allegation that there was any impropriety in advancing loan proceeds.

With respect to the alleged substantial assistance in "entering into transactions with the Company's affiliates that they knew were not authorized" (Amended Complaint, ¶ 203), plaintiffs claim that Wells Fargo and KeyCorp possessed copies of the Operating and Amended Operating Agreements and, therefore, knew that plaintiffs' consent was required prior to entering into certain transactions. *Id.*, ¶¶ 76, 89, 137. However, the deletion of section 9(i)(ii) in the Amended Operating Agreement cancelled the unanimous consent requirement with respect to loan modifications. Moreover, plaintiffs' argument that the deletion of section 9(i)(ii) was a scrivener's error supports the conclusion that neither Wells Fargo nor KeyCorp had any reason to know of any impropriety or require any additional consent. *Decana Inc. v Contogouris*, 55 AD3d 325, 326 (1st Dep't 2008), *lv dism* 11 NY3d 920 (2009) (affirming summary judgment dismissal of claim for aiding and abetting breach of fiduciary duty against defendant bank, where president and sole director of plaintiff corporation had actual and apparent authority to mortgage corporate property, and

circumstances did not give rise to duty to inquire into the scope of the claimed authority). For the foregoing reasons, the third cause of action is dismissed.

II. Money Had and Received (11th Cause of Action)

Wells Fargo and KeyCorp seek dismissal of the eleventh cause of action for money had and received, a derivative claim based upon their receipt of, and benefit from, the $5 million modification Fee and the $3.4 million Special Payment. It is undisputed that these payments were made pursuant to the Forbearance and Modification Agreements. Amended Complaint, ¶¶ 116, 123, 245, 248. Therefore, the cause of action for money had and received must be dismissed. *Egnotovich*, 55 AD3d 462, *supra; Street Search Partners., L.P.*, 2005 WL 1953094, 2005 Del Super LEXIS 246, *supra*. This claim is subject to dismissal for the additional reason that Wells Fargo and KeyCorp did not act inequitably, or in violation of principles of good conscience, in receiving the payments (as discussed more fully above, in connection with plaintiffs' third cause of action for aiding and abetting breach of fiduciary duty).

Accordingly, it is hereby

ORDERED that the motion of defendants SE West 57 Property, LLC, SE West 57 Management, LLC, Kent Swig, Swig Equities, LLC, and Falcon Pacific Construction, LLC (motion sequence number 007) is

(1) granted to the extent of dismissing

(a) plaintiffs' first, fifth, sixth, eleventh and twelfth causes of action to the extent asserted derivatively on behalf of 322 West 57th Owner LLC;

(b) the first and second causes of action to the extent asserted against defendants Swig Equities, LLC and Falcon Pacific Construction, LLC;

(c) the first and second causes of action to the extent based upon allegations of unauthorized loan refinancing, as alleged in paragraphs 48-90 of the Amended Complaint; misuse of condominium reserve funds, as alleged in paragraphs 164-167 of the Amended Complaint; and failure to pay condominium common charges, as alleged in paragraphs 168-171 of the Amended Complaint;

(d) the fourth cause of action for breach of contract, to the extent of dismissing allegations based upon unauthorized refinancing of loans, as alleged in paragraphs 48-90 of the Amended Complaint; entering into Forbearance and Modification Agreements without plaintiffs' consent, as alleged in paragraphs 111-130 of the Amended Complaint; the hiring of defendant Falcon Pacific Construction, LLC and its hiring of nonparty Pinnacle Contractors of NY, Inc., as alleged in paragraphs 91-101 of the Amended Complaint; and breaches of sections 9(j)(ii)(H), 9(j)(ii)(J), 9(j)(ii)(O), and section 20 of the Operating Agreement, as alleged in paragraphs 172 - 175 and 177 of the Amended Complaint;

(e) the fifth cause of action, to the extent asserted against defendants SE West 57 Property, LLC and SE West 57 Management, LLC; and

(f) the sixth cause of action in its entirety,

(2) and the motion is otherwise denied; and it is further

ORDERED that the motion of defendants KeyCorp Real Estate Capital Markets, Inc. and Wells Fargo Bank, N.A., As Trustee For the Credit Suisse First Boston Mortgage Securities Corp. Commercial Mortgage Pass-Through Certificates Series 2006 Tfl2 (motion sequence number 009) is granted and the Amended Complaint is dismissed in its entirety as against said defendants, without costs or disbursements, and the Clerk is directed to enter judgment accordingly in favor of said defendants; and it is further

ORDERED that the action is severed and continued against the remaining defendants: SE West 57 Property, LLC, SE West 57 Management, LLC, Kent Swig, Swig Equities, LLC, and Falcon Pacific Construction, LLC; and it is further

ORDERED that defendants SE West 57 Property, LLC, SE West 57 Management, LLC, Kent Swig, Swig Equities, LLC, and Falcon Pacific Construction, LLC are directed to serve an answer to the remaining

claims in the Amended Complaint within 20 days after service of a copy of this order with notice of entry; and it is further

ORDERED that counsel are directed to appear for a status conference in IA Part 39, 60 Centre Street - Room 208 on May 2, 2012 at 10:00 a.m.

This constitutes the decision and order of this Court.

Date: March 20, 2012

Barbara R. Kapnick
J.S.C.

BARBARA R. KAPNICK
J.S.C.