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OF THE
STATE OF DELAWARE

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Re: *Ross Holding and Management Company, et al. v. Advance Realty Group, LLC, et al.*
C.A. No. 4113-VCN
Date Submitted: November 1, 2012

Dear Counsel:

Plaintiffs own units of Defendant Advance Realty Group, LLC ("ARG"), a New Jersey-based real estate development enterprise. The Individual Plaintiffs were high-ranking executives of ARG until their termination in 2007. The Entity Plaintiffs are owned by Individual Plaintiffs. A wide range of claims has been asserted. Two require attention at this point. First, the Plaintiffs complain about ARG's refusal to redeem their units at market value. Second, the Plaintiffs challenge the Conversion and Exchange Agreement (the "Conversion

Agreement"), adopted in September 2008, which involved a capital restructuring of ARG. The Plaintiffs claim that the Conversion Agreement materially and adversely affected the value of their ARG holdings because other Defendants who control ARG diverted its assets for their benefit.[1]

The Defendants have moved for partial summary judgment on nine grounds.[2] Before turning to each of the reasons sponsored by the Defendants, the standards governing the Court's consideration of a motion for partial summary judgment should be briefly reviewed. Summary judgment, governed by Court of Chancery Rule 56, requires the Court to view the facts in the light most favorable to the nonmoving party.[3] The moving party must demonstrate that there is no material question of fact.[4] Then, the moving party may prevail on its motion if it is entitled to judgment as a matter of law.

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[1] This incomplete summary of the dispute provides sufficient context for the matters before the Court. A fuller development of the background may be found at *Ross Hldg. & Mgmt. Co. v. Advanced Realty Gp., LLC*, 2010 WL 1838608, at *1-4 (Del. Ch. Apr. 28, 2010) (Defendants' Motion for Judgment on the Pleadings) and *Ross Hldg. & Mgmt. Co. v. Advanced Realty Gp., LLC*, 2010 WL 3448227, at *1-2 (Del. Ch. Sept. 2, 2010) (Plaintiffs' Motions to Amend Their Complaint and for the Appointment of a Receiver).
[2] The parties waived oral argument on the Defendants' motion for partial summary judgment.
[3] *Merrill v. Crothall-Am., Inc.*, 606 A.2d 96, 99 (Del. 1992); *see also Cerberus Int'l., Ltd. v. Apollo Mgmt., L.P.*, 794 A.2d 1141, 1150 (Del. 2002).
[4] *Whittington v. Dragon Gp. L.L.C.*, 2008 WL 4419075, at *3 (Del. Ch. June 6, 2008).

1. The Unopposed

The Defendants have sought dismissal of (i) Defendant Rothschild Realty, Inc. for lack of personal jurisdiction; (ii) the Plaintiffs' claim for punitive damages for lack of subject matter jurisdiction; and (iii) the Plaintiffs' claims for attorneys' fees and costs because they have not demonstrated any basis for fee shifting.[5] The Plaintiffs do not contest these aspects of the Defendants' motion,[6] and partial summary judgment will be entered as to each of these elements.[7]

2. The Unit Holders Agreements

The Plaintiffs have alleged that ARG breached the Unit Holders Agreements by failing to repurchase their Class A units of ARG when the Individual Plaintiffs were terminated. The Unit Holders Agreements provide that, upon termination, "[ARG] may repurchase some or all of the Units of Investor" under certain terms.[8] The use of the word "may," as contrasted with the word "shall," denotes a

[5] The Court does not understand the Defendants' motion to reach traditional "court costs."
[6] Pls.' Br. in Opp'n to Defs.' Mot. for Summ. J. ("Pls.' Br.") 5.
[7] This conclusion moots the balance of the motion on behalf of Defendant Rothschild Realty, Inc. to the extent that it sought an analysis of the merits of the claims against it.
[8] Aff. of Joseph A. Martin, Esq. ("Martin Aff.") Ex. 8 (the "Unit Holders Agreement") § 7(a).

permissive standard.[9] ARG, thus, had no express duty to repurchase the Class A units.

Under New Jersey law, in every contract inheres an implied covenant of good faith and fair dealing. Thus, even if a contract gives a party discretion to undertake or to refrain from undertaking a particular act, the implied covenant may, nevertheless, be breached if, for example, the party exercises its discretion deliberately and with a dishonest purpose or with the intent to profit at the expense of another party that conflicts with the "spirit of the contract."[10] The reasons for the implied covenant are most obvious when a party "has acted consistent with the contract's literal terms, but has done so in such a manner so as to 'have the effect of destroying or injuring the right of the other party to receive the fruits of the contract.'"[11] Care must be taken, however, not to give the implied covenant a

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[9] *See, e.g.*, *Aponte-Correa v. Allstate Ins. Co.*, 744 A.2d 175, 179 (N.J. 2000). The parties agree that the law of New Jersey governs. Defs.' Reply Br. in Supp. of Defs.' Mot. for Partial Summ. J. 8 n.3.

[10] *Rodin Props.-Shore Mall, N.V. v. Cushman & Wakefield of Pa., Inc.*, 49 F. Supp. 2d 728, 735-36 (D.N.J. 1999).

[11] *Wade v. Kessler Inst.*, 798 A.2d 1251, 1262 (N.J. 2002) (quoting *Bak-A Lum Corp. of Am. v. Alcoa Bldg. Products, Inc.*, 351 A.2d 349, 352 (N.J. 1976)).

reach too broad; otherwise, it might "impos[e] unintended obligations upon parties and destroy[] the mutual benefits created by legally binding agreements."[12]

The Plaintiffs stress that they expected that their units would be acquired by ARG if they were terminated. If that was their expectation in 2001 when they executed the Unit Holders Agreements, they had a strange way to incorporate that expectation into the agreements; indeed, the contractual language, to which they, of course, agreed, is inconsistent with what they now claim was not only their expectation but also the expectation of all parties to those agreements. The Plaintiffs' expectation that ARG was obligated to reacquire their units is different from the possibility that ARG might choose to acquire their units. Their expectations were not incorporated into the contract; nonetheless, the implied covenant may have required ARG to act in good faith when it decided whether or not to purchase their units.

The Individual Plaintiffs' ownership of ARG units was an incentive and potential reward for their service. One can understand why they would not want to

[12] *Brunswick Hills Racquet Club, Inc. v. Route 18 Shopping Ctr. Assocs.*, 864 A.2d 387, 399 (N.J. 2005) (citation omitted).

be minority unit holders of an enterprise controlled by those who had acted adversely toward them, but it is hard to see why that is an "inequitable" result. Their problem is not so much that their units were not purchased; it is how those units were treated by their fiduciaries.

The Plaintiffs cite some specific instances that, they say, reaffirm their expectations. For example, after their termination, an ARG executive (perhaps, misleadingly) gave them reason to believe that their units would be bought upon the occurrence of certain events. ARG, of course, had the right to purchase after termination, and that such offers were bandied about well after the Unit Holders Agreements were executed offers little support to the Plaintiffs' claim that such an opportunity should be an implied part of these contracts. They also point to another former employee of ARG who held Class A units of ARG (as they still do) and whose units were purchased after his termination. That purchase, orchestrated at the time by one of the Plaintiffs, reflects what the contract expressly allowed: ARG could choose to purchase Class A units upon an employee's termination. The Plaintiffs have not developed a cohesive theory to explain why the differential

treatment they have identified is somehow proof that an implied covenant should be given effect.

Ultimately, especially in light of the discretionary language in the Unit Holders Agreements, the Plaintiffs have offered nothing to support the "reasonable expectation" in 2001 that they could force ARG to buy back their units in the event they were terminated.

The Plaintiffs asserted their implied covenant claim in Count 7 of the Amended Complaint. ARG is entitled to summary judgment in its favor on this count.

Count 8 of the Amended Complaint contains the Plaintiffs' claims against various other Defendants for tortiously interfering with their Unit Holders Agreements and dissuading ARG from buying back their Class A units. One of the critical elements of a claim for tortious interference with contract is that a contract must have been breached."[13] Because ARG did not breach the Unit Holders Agreements and it did not breach any implied covenant of good faith and fair

[13] *Nostrame v. Santiago*, 22 A.3d 20, 24 (N.J. Super. Ct. App. Div. 2011) (citing Restatement (Second) of Torts § 766 (1974)).

dealing under those agreements when it did not repurchase the Class A units, no tortious interference could have occurred with respect to the Unit Holders Agreements and the Plaintiffs' demands that their Class A units be repurchased.

Accordingly, the Defendants, other than ARG, are granted summary judgment in their favor on Count 8 of the Amended Complaint.

3. Ronald L. Rayevich and Fiduciary Duty

Defendant Ronald L. Rayevich ("Rayevich") served as a member of ARG's managing board which, under the terms of ARG's Operating Agreement, had the duty to "manage the business and affairs of [ARG] . . . reasonably and in good faith."[14] Rayevich, who is presumed to have "acted on an informed basis, in good faith and in the honest belief that the action taken was in the best interests of [ARG],"[15] is exculpated from liability for "any action or inaction" that did not "arise out of . . . willful misconduct or bad faith."[16] Although a member of ARG's managing board, Rayevich had no discretion in how to vote as a member; he was

[14] Martin Aff. Ex. 2 (ARG Operating Agreement) § 7.01.
[15] *Gantler v. Stephens*, 965 A.2d 695, 705-06 (Del. 2009) (internal quotation marks and citation omitted).
[16] ARG Operating Agreement § 7.10(a).

required to follow Defendant Peter Cocoziello's ("Cocoziello") instructions.[17] Nonetheless, the Plaintiffs allege that Rayevich breached his fiduciary duties by (1) failing "to evaluate the terms of the Conversion Agreement to determine whether it was in the best interests of the company and its unit holders"; (2) by failing to "voice[] opposition to the [a]greement in light of the conflicts of interest involving his fellow [b]oard members"; and (3) by failing to take "any steps to prevent the self-dealing of the insider [d]efendants."[18] Rayevich has moved for summary judgment with respect to the claims that he breached his fiduciary duties because, first, the Plaintiffs have not overcome the presumption that he acted in good faith and, second, even if he did breach his fiduciary duties, he was not acting willfully or in bad faith and therefore is exculpated from liability.

Rayevich cannot avoid liability simply by pointing out that he had no discretion—as restricted by the ARG Operating Agreement—to vote as a board member. He is correct that Cocoziello controlled his vote, but fiduciary duties

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[17] *Id.* at § 7.01. Rayevich was a "Principal Designee" to the Managing Board and "Cocoziello [was] entitled to cast all votes on behalf of the Principal Designees." *Id.* Cocoziello founded ARG and, at the time, he was its President and Chief Executive Officer. He also was a member of its managing board.
[18] Pls.' Br. 6-7.

extend beyond voting. They may involve, for example, studying the proposed action, determining the appropriateness of the proposed action, setting forth a dissenting view to fellow board members, and, in the proper circumstances, informing unit holders about the potential adverse affects of a proposed action.

It might be relatively easy to second guess Rayevich's efforts, but second guessing is not a substitute for the Plaintiffs' burden to sponsor facts that demonstrate his lack of good faith. They claim that he was "asleep at the wheel," but the facts on which that claim is based are not identified. He may have done very little, and he may have done a poor job, but there is no showing that he was not independent and disinterested with respect to the challenged action—essentially, the Conversion Agreement—and there is no showing that he was not informed about the Conversion Agreement or that he had not considered the Conversion Agreement.[19] His conduct may not deserve the continuing presumption of good faith or the right to exculpation, but the Plaintiffs have not put forth facts—other than the most conclusory allegations—demonstrating that his

[19] He describes his role by affidavit. *See* Aff. of Ronald Rayevich ¶¶ 2-4. The affidavit may be criticized as self-serving, but it offers more than the Plaintiffs have presented. He resigned from ARG's managing board at the end of the meeting during which the Conversion Agreement had been approved.

conduct was willful or in bad faith. Specific facts, as contrasted with mere allegations, are needed to resist a motion for summary judgment.[20] The Plaintiffs' inability or disinclination to supply the minimum factual showing required to avoid summary judgment entitles Rayevich to summary judgment with respect to Count 1 of the Amended Complaint.

4. Patricia K. Sheridan and Fiduciary Duty

Defendant Patricia K. Sheridan ("Sheridan") served as ARG's Chief Financial Officer and does not dispute that she owed fiduciary duties to the Plaintiffs who are ARG unit holders. She is alleged to have "misstated material information in the financial statements of ARG, omitted material information from the financial statements of ARG, and misrepresented material facts to [P]laintiffs (and failed to disclose material facts) regarding, and to hide, the self-dealing of the other [D]efendants."[21] The Plaintiffs also contend that Sheridan implemented Defendants' strategy "to force [P]laintiffs out as unit holders of ARG, which included, but was not limited to, sending the September 12, 2008 letter to Class A

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[20] *See Winshall v. Viacom Int'l Inc.*, 2012 WL 6200271, at *4 (Del. Ch. Dec. 12, 2012) (noting that party opposing summary judgment cannot rely on mere allegations or denials to create a dispute of material fact, but must set forth specific facts).
[21] Am. Compl. ¶ 230.

unit holders."[22] Finally, they assert that she also breached her fiduciary duties by "otherwise actively engaging in the conspiracy more fully alleged herein and in Count 10 below."[23] Sheridan seeks summary judgment on these claims.

Corporate fiduciaries may breach their general fiduciary duty to shareholders if they issue misleading disclosures even though those disclosures do not relate to a specific request for shareholder action.[24] A comparable liability exists within the management framework of a limited liability company, its managing board, and its unit holders. In this context, *i.e.*, when no shareholder or unit holder action is sought, a plaintiff must prove that the fiduciary "knowingly disseminat[ed] materially false information."[25] In addition, the plaintiff must also show reasonable reliance, causation, and damages.[26] The Plaintiffs are unable to demonstrate that Sheridan's statements, assuming they were false, caused them any damage. They have also been unable to demonstrate that they relied (or acted in

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[22] *Id.* at 231.
[23] *Id.*
[24] *Malone v. Brincat*, 722 A.2d 5, 14 (Del. 1998).
[25] *Id.*
[26] *Metro Commc'ns Corp. BVI v. Advanced Mobilecomm Techs. Inc.*, 854 A.2d 121, 158 n.84 (Del. Ch. 2004); *A.R. DeMarco Enters., Inc. v. Ocean Spray Cranberries, Inc.*, 2002 WL 31820970, at *4 n.10 (Del. Ch. Nov. 26, 2002).

reliance) on any of her misrepresentations. Without placing such facts in the record, the Plaintiffs' claims must succumb to Sheridan's motion for summary judgment.[27]

The Plaintiffs also maintain that the September 12, 2008 letter authored by Sheridan demonstrates a breach of her fiduciary duties. However, that letter was written after the Conversion Agreement was approved, and there is no evidence that the Plaintiffs in any way relied upon any statement in that letter. This allegation fails for the same reason as the other fraud or disclosure-related claims fail. Finally, the Plaintiffs allege that Sheridan engaged in a civil conspiracy to deprive them of their rights as ARG unit holders, and that this conduct constituted a breach of her fiduciary duties. The threshold question raised by this contention is whether the Plaintiffs have set forth specific facts that tend to show that Sheridan knowingly participated in, or agreed to, the alleged conspiracy. Resolution of that question is set forth below.

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[27] The Court need not resolve the debate about the sufficiency of pleading what amounts to a fraud claim in the context of a fiduciary duty claim. In brief, Sheridan contends that the Amended Complaint fails to plead fraud with the specificity required by Court of Chancery Rule 9(b).

6. Civil Conspiracy[28]

The Plaintiffs contend that all of the Defendants engaged in civil conspiracy, "the net effect of which was to deprive [P]laintiffs of the value of their Class A units."[29]

Under New Jersey law, a plaintiff seeking to prove a civil conspiracy must demonstrate "a combination of two or more persons acting in concert to commit an unlawful act, or to commit a lawful act by unlawful means, the principal element of which is an agreement between the parties to inflict a wrong against, or injury

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[28] Under Delaware law, a civil conspiracy based on an underlying breach of fiduciary duty is sometimes called "aiding and abetting." *Weinberger v. Rio Grande Indus., Inc.*, 519 A.2d 116, 131 (Del. Ch. 1986); *see Malpiede v. Townson*, 780 A.2d 1075, 1097-98 (Del. 2001) (noting that a "bidder may be liable to a target's stockholders for aiding and abetting a fiduciary breach by the target's board where the bidder and the board conspire in or agree to the fiduciary breach"). Though closely related, the two causes of actions are not identical. An aiding and abetting claim "focuses on the wrongful act of providing assistance, unlike civil conspiracy that focuses on the agreement." *Hospitalists of Delaware, LLC v. Lutz*, 2012 WL 3679219, at *15 (Del. Ch. Aug. 28, 2012) (internal quotation marks omitted) (quoting *WaveDivision Hldgs., LLC v. Highland Capital Mgmt. L.P.*, 2011 WL 5314507, at *17 (Del. Super. Nov. 2, 2011), *aff'd*, 49 A.3d 1168 (Del. 2012)). Under certain circumstances, the distinction may not be meaningful and the relief from both actions may be duplicative. *Id*. To state an aiding and abetting claim, a plaintiff must show (1) the existence of a fiduciary relationship; (2) a breach of the fiduciary's duty; (3) a defendant's knowing participation in the breach; and (4) damages proximately caused by the breach. *Malpiede*, 780 A.2d at 1096. A civil conspiracy claim requires: "(1) [a] confederation or combination of two or more persons; (2) [a]n unlawful act done in furtherance of the conspiracy; and (3) [a]ctual damage." *Nicolet, Inc. v. Nutt*, 525 A.2d 146, 149-50 (Del. 1987).

[29] Am. Compl. ¶ 274.

upon another, and an overt act that results in damage."[30] The Defendants primarily challenged the Plaintiffs' proof of an agreement. They note that several of the alleged conspirators had adverse interests with respect to the ARG restructuring. For example, Defendant Kurt R. Padavano, as a Class A unit holder, was adversely affected by the Conversion Agreement. Some of the supposed conspirators were equity holders; others were debt holders. Again, there was distension between the equity holders and the debt holders. The Defendants also note that Rayevich and Sheridan had no financial interest in ARG and, thus, had no personal interest in the restructuring. Moreover, some of the parties to the Conversion Agreement—alleged co-conspirators—agreed to the terms of the Conversion Agreement. Can that sort of written confirmation of a business transaction constitute the agreement needed as an element to demonstrate the existence of a conspiracy?

Ultimately, for present purposes, there is a dispute of material fact whether the Defendants, other than Rayevich and Sheridan, reached an agreement to pursue the Conversion Agreement and, thus—at least according to Plaintiffs—to harm the

[30] *Banco Popular N. Am. v. Gandi*, 876 A.2d 253, 263 (N.J. 2005) (internal quotation marks and citation omitted).

Plaintiffs to their benefit. Wrongful conduct has been alleged, and it is a reasonable (but not necessary) inference that those Defendants agreed to use the Conversion Agreement as a means of achieving advantages to which they were not entitled. That, for this state of the proceedings, suffices, and the Court cannot conclude, as a matter of undisputed material fact, that Defendants, other than Rayevich and Sheridan, are entitled to judgment as a matter of law.[31]

The question of whether Rayevich and Sheridan, as contrasted with the other Defendants, are entitled to summary judgment on the conspiracy claim remains. Civil conspiracy requires either an unlawful act or a lawful act committed by unlawful means.

The Plaintiffs have identified no overt action—lawful or otherwise—that shows that Rayevich knowingly participated in, or agreed to, the conspiracy which

[31] The benefits to Plaintiffs of a pending civil conspiracy claim are not all that apparent. Evidentiary matters may be facilitated, but, eventually, either there were breaches of fiduciary duty (perhaps as defined in the ARG Operating Agreement) or there were not. The civil conspiracy claims are brought under New Jersey law. Many of the Plaintiffs' substantive claims are based on Delaware law. How Delaware substantive law and New Jersey conspiracy law interface (and whether that convergence carries any consequences) has not been addressed by the parties.

they seek to prosecute. Thus, he is entitled to summary judgment on the conspiracy claim against him.

Sheridan, however, was actively involved in preparing the financial statements associated with the lead up to the Conversion Agreement and its implementation. In her September 2008 letter, she advised Plaintiffs of the declining value of their interests in the restructured ARG—as part of the strategy employed by the Defendants generally to undermine Plaintiffs' confidence in their investment. Her role in developing and working on the lead up to the Conversion Agreement provides a reasonable basis to support the inference that she agreed to the terms and purpose of the Conversion Agreement. Her actions supporting the Conversion Agreement—even if those actions were legal—were part of the implementation of the plan—on this record, one of the reasonable inferences is that that was a conspiracy—that was carried out through the Conversion Agreement which, for present purposes, was an agreement to inflict a wrong upon the Plaintiffs. Her efforts were an integral part of the Defendants' scheme and were

consistent with it. Perhaps this does not amount to much; it is, however, sufficient to preclude the granting of summary judgment to Sheridan.[32]

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Accordingly, the Defendants are entitled to summary judgment as to Plaintiffs' claims (i) for punitive damages; (ii) for attorneys' fees; (iii) against Rayevich; (iv) for the failure to purchase the Plaintiffs' ARG units under the terms of the Unit Holders Agreements; and (v) for tortious interference with those alleged repurchase rights under the Unit Holders Agreements. Otherwise, Defendants' Motion for Partial Summary Judgment is denied.

IT IS SO ORDERED.

Very truly yours,

/s/ John W. Noble

JWN/cap
cc: Charles J. Brown, III, Esquire
Register in Chancery-K

[32] Participation in a civil conspiracy against some ARG unit holders precludes dismissal, at this stage, of the fiduciary duty claims against her.