Fried v Lehman Bros. Real Estate Assoc. III, L.P.
2016 NY Slip Op 31490(U)
August 5, 2016
Supreme Court, New York County
Docket Number: 651461/11
Judge: Saliann Scarpulla
Cases posted with a "30000" identifier, i.e., 2013 NY Slip Op 30001(U), are republished from various state and local government websites. These include the New York State Unified Court System's E-Courts Service, and the Bronx County Clerk's office.
This opinion is uncorrected and not selected for official publication.

[* 1]

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

---x

BARBARA J. FRIED; ALTITUDE PARTNERS, LLC; RICHARD D. MALTZMAN, AS TRUSTEE FOR THE RICHARD D. & CHARLENE MALTZMAN FAMILY TRUST; JEFFOREED PARTNERS, L.P.; ZELFAM, LLC; on behalf of themselves and other limited partners joining them,

Plaintiffs,

Index No. 651461/11

-against-

LEHMAN BROTHERS REAL ESTATE ASSOCIATES III, L.P.; LEHMAN BROTHERS PRIVATE EQUITY ADVISERS, LLC; REAL ESTATE PRIVATE EQUITY, INC.; SILVERPEAK REAL ESTATE PARTNERS, LP; REPE CP MANAGECO, LLC; MARK A. WALSH; MARK H. NEWMAN; BRETT BOSSUNG; RODOLPHO AMBOSS; KEVIN DINNIE; MICHAEL J. ODRICH; CHRISTOPHER M. O'MEARA; RICHARD S. FULD, JR.; JOSEPH M. GREGORY; ERIN CALLAN; IAN LOWITT; THOMAS RUSSO; & JOHN DOE 1 through 50,

Defendants.

---x

Saliann Scarpulla, J.:

Motions bearing sequence numbers 003, 004 and 005 are consolidated for disposition.

This is an action for fraud, breach of fiduciary duty, breach of contract and a declaratory judgment arising from several real estate investment partnerships formed in 2007. The gravamen of the amended complaint ("complaint") is that defendants induced plaintiffs to invest in the partnerships in order to rid themselves of devalued properties at plaintiffs' expense.

In motion sequence 003, defendants Lehman Brothers Real Estate Associates III L.P., Lehman Brothers Private Equity Advisers, LLC, Real Estate Private Equity, Inc., Michael J. Odrich, Christopher M. O'Meara, Richard S. Fuld, Jr., Joseph M. Gregory, Erin Callan, Ian Lowitt and Thomas Russo move, pursuant to CPLR 3211 (a) (1) and (7), for an order dismissing the complaint. In motion sequence 004, defendants Mark A. Walsh, Mark H. Newman, Brett Bossung, Rodolpho Amboss, Kevin Dinnie, Silverpeak Real Estate Partners, LP, and REPE CP ManageCo, LLC move, pursuant to CPLR 3211 (a) (1) and (7), for an order dismissing the complaint.

In motion sequence 005, defendants Lehman Brothers Real Estate Associates III, L.P., Lehman Brothers Private Equity Advisers, LLC, and Real Estate Private Equity, Inc. move for permission to supplement the record.

The facts set forth below are drawn from plaintiffs' amended complaint, filed February 3, 2015, unless otherwise indicated.

Parties

According to the complaint, plaintiffs are each limited partners in one of eleven partnerships formed for the purpose of investing in commercial real estate. The partnerships operated collectively under the name Lehman Brothers Real Estate Partners III ("LBREP III" or "partnerships") and were formed primarily in June 2007 by non party Lehman Brothers Holdings, Inc. ("Lehman").

Defendant Lehman Brothers Real Estate Associates III, L.P. ("LBREA III" or "General Partner") was the general partner of the various partnerships, and defendant Lehman Brothers Private Equity Advisers, LLC ("LBPEA") was the original investment advisor to the partnerships. LBPEA was replaced in that role by defendant Silverpeak Real Estate Partners, LP ("Silverpeak") in 2010. Silverpeak was controlled by defendants Mark A. Walsh, Brett Bossung, Mark H. Newman, Rodolpho Amboss and Kevin Dinnie, each of whom was also originally involved in operating LBREA III.

The other individual defendants, Michael J. Odrich, Christopher M. O'Meara, Richard S. Fuld, Jr., Joseph M. Gregory, Erin Callan, Ian Lowitt and Thomas Russo are referred to in the complaint as Lehman officials with access to, and knowledge of, its confidential records.

Defendant Real Estate Private Equity, Inc. ("REPE") was formed in 2005 by Lehman and it originally held the various real estate assets that were transferred to each of the partnerships after the plaintiffs became limited partners. REPE CP ManageCo, LLC was an entity formed in Delaware by Walsh, Bossung, Newman, Amboss and Dinnie to carry on the business of LBREP III.

Background

In the fall of 2007, the partnerships distributed private placement memoranda ("PPMs") and supplements to the PPMs ("Supplements"), to prospective investors. The PPMs stated that certain properties would be purchased by Lehman and warehoused until investors were admitted as partners. The properties would then be transferred to the partnerships at their acquisition costs, plus Lehman's cost of carry, which was not to exceed 9% per annum.

The PPMs also stated, among other things, that the General Partner would create an unaffiliated Investor Advisory Committee ("IAC") to review transactions in which the General Partner had conflicts of interest, and to consult on write-downs of property valuations. It is undisputed that the first Supplement, issued in November 2007, disclosed the identities of properties that were being considered for transfer to the partnerships, including most of the properties that eventually were transferred.

The majority of the plaintiffs signed Subscription Agreements by November 2007, and all of them were admitted as limited partners by March of 2008. Their limited partnership interests were governed by limited partnership agreements ("LPAs") which provided, among other things, that the limited partners would forfeit 50% of their capital accounts if they failed to pay capital contributions upon notice. The first capital call was made on March 28, 2008.

The amended complaint states that, on May 28, 2008, Lehman sold 26 properties to LBREP III, at prices above their current market value. Three days later, on May 31, 2008, the U.S. Office of Thrift Supervision concluded an examination of Lehman, finding that Lehman failed to employ sound risk management practices in its commercial real estate business. Plaintiffs state that, on June 9, 2008, Lehman filed a Form 8-K, reporting its first quarterly loss, due to related mark-downs in commercial real estate values. On September 10, 2008, Lehman pre-announced a $3.9 billion net loss for the 3d Quarter of 2008 and on September 15, 2008, Lehman filed for Chapter 11 bankruptcy.

According to the amended complaint, defendants delayed in revealing the May 28th sales of Lehman properties to LBREP III, as well as the losses that investors incurred, until December 5, 2008. Defendants also allegedly failed to issue any 2nd Quarter 2008 financial statements, as the LPAs required, because such statements would have required a GAAP-based "Fair Value" estimate of property values, which would have

revealed the losses that investors had incurred. Instead, in June 2008, defendants created a non-GAAP Valuation Summary ("Valuation Summary") which stated that LBREP III's portfolio had increased in value by 2.4%. The parties sharply dispute whether the Valuation Summary was sent to the limited partners, including plaintiffs.

Plaintiffs allege that no LBREP III quarterly financial statements appeared until December 5, 2008, after Lehman's bankruptcy filing. These statements listed LBREP III's commercial real estate properties at Fair Value, and allegedly revealed a 30% drop in value compared to the original purchase price by Lehman. The complaint states that, in February 2010, the management team of the General Partner, *i.e.*, defendants Amboss, Bossung, Dinnie, Newman and Walsh, began a campaign to acquire the management business of the General Partner. To that end, they needed to obtain the consent of LBREP III limited partners to amend the LPAs to create a Ninth LPA, and to approve a new agreement with the manager's new company, which eventually became Silverpeak. Plaintiffs state that the Ninth LPA proposed a dramatic increase in the fees that would be paid to the management team at Silverpeak.

In October of 2009, plaintiffs in this action commenced an action in federal court in New York against these defendants, alleging various causes of action under the federal securities laws. In March 2011, the district court dismissed the complaint. *See Fried v*

Lehman Brothers Real Estate Associates III, L.P., 2011 WL 1345097, 2011 US Dist Lexis 40431 (SD NY 2011), *affd* 506 Fed Appx 5 (2nd Cir 2012).

First, the court stated that:

> The core of Plaintiff's case is the allegation that Lehman omitted material information regarding the LBREP III Partnerships from the PPM, supplements to the PPM, and the LPA. They allege that Defendants knew and failed to disclose that upon transfer of the warehoused properties, the limited partners would immediately sustain major losses to the value of their holdings because the properties had lost significant value since their acquisition by Lehman.

Id. at *3, *11.

The court then found, among other things, that plaintiffs failed to plead the element of scienter. Specifically, the court stated that:

> Plaintiffs have alleged no facts indicating that Defendants knew or should have known of any losses to the LBREP III properties as of March 2008. Mere observations about trends in the commercial real estate market generally. . . . do not support Plaintiffs' allegation that Defendants should have known that the LBREP III warehoused properties had decreased in value as of March 1, 2008.

Id. at *8, *24.

Relevant here, the court also noted that

> Supplement One to the PPM, issued before any Plaintiff committed to invest in LBREP III, gave substantial details regarding every property under consideration at that time. For each investment opportunity, the document described the expected total investment, money invested to date, and plans

> for future development, as well as important details regarding the property's intended use, location, and business plan. Additionally, that document also described changes happening in the market during the fall of 2007 that could affect LBREP III investments . . . Thus, Plaintiffs had information regarding most of the LBREP properties prior to investing and could have engaged in their own investigation to determine whether the properties were likely to gain or lose value relative to the Lehman purchase price.

Id. at *8, *25.

The district court's decision was affirmed by the Second Circuit in 2012. *Fried v Lehman Bros. Real Estate Associates III, L.P.*, 506 Fed Appx 5 (2d Cir 2012), Among other things, the Second Circuit noted that internal Lehman documents indicated that, as of December 31, 2007, the partnership-bound investment properties had, in aggregate, appreciated $300,000 in value since their acquisition. *Id.* at 8.

Plaintiffs filed this action on May 27, 2011, and defendants removed it to federal court on June 17, 2011. The District Court stayed the removed action pending the conclusion of the Second Circuit appeal. Plaintiffs filed an amended complaint (the "Federal Complaint") on February 28, 2013 and on May 30, 2013, the case was remanded back to this court.

In a decision dated January 7, 2015, this court denied, as moot, defendants' motion to dismiss the Federal Complaint and gave plaintiffs permission to file an amended complaint in this court. Plaintiffs filed an amended complaint on February 3, 2015.

Motion Sequence 005

In motion sequence 005, defendants move to supplement the record with respect to motion sequence 003 and motion sequence 004. Specifically, defendants request permission to introduce a brief submitted by plaintiffs to the Second Circuit (Second Circuit Brief).

At issue here is the parties' dispute over the Valuation Summary described above, which was created in June 2008 and which stated that LBREP III's portfolio had increased in value by 2.4% at that time. The parties sharply disputed, at oral argument of motions 003 and 004, whether the Valuation Summary was sent to plaintiffs at any point. At oral argument on motions 003 and 004, plaintiff's counsel stated that plaintiffs told him that they had received the Valuation Summary. Defendants contend that the Valuation Summary was not sent to investors, including plaintiffs.

Defendants now seek to introduce the Second Circuit Brief to contradict plaintiffs' assertion. Specifically, they contend that the brief contains a statement by plaintiffs which indicates that the Valuation Summary was an internal document of defendants and was never sent to investors, including plaintiffs. Defendants further contend that, in any event, plaintiffs could not have relied on the Valuation Summary because it was created after plaintiffs made their investments.

Plaintiffs contend that the Second Circuit Brief states only that the Valuation Summary was an "internal" document in the sense that it was not GAAP-compliant, *i.e.*, that it was not created under public accounting rules. They contend that describing the Valuation Summary as "internal" does not also mean that plaintiffs never received it. Plaintiffs further contend that, in any event, they are not relying on the Valuation Summary to support a claim for fraudulent inducement. Instead, they argue that it is relevant because it was not prepared under GAAP standards and constituted an attempt by defendants to conceal the true value of the properties.

As described above, the parties dispute whether the Valuation Summary was sent to investors. They further dispute the meaning of plaintiffs' description of the Valuation Summary as an internal document. However, plaintiffs have not demonstrated any prejudice or surprise from introduction of the Second Circuit Brief and plaintiffs have had an opportunity to be heard in opposition to defendants' request to supplement the record. Therefore, I permit defendants to supplement the record and I will consider the Second Circuit Brief for whatever probative value it has, if any, in consideration of motion sequences 003 and 004.

Motion Sequences 004 and 005

Defendants move to dismiss the complaint for failure to state a cause of action. "On a motion to dismiss pursuant to CPLR 3211, the pleading is to be afforded a liberal

construction." *Amaro v Gani Realty Corp.*, 60 AD3d 491, 492 (1st Dept 2009), citing *Leon v Martinez*, 84 NY2d 83, 87-88 (1994). "The court must accept the facts alleged in the complaint as true and accord the plaintiffs the benefit of every possible favorable inference." *Id.*, citing *Leon v Martinez*, 84 NY2d at 87.

Fraud

Plaintiffs assert causes of action for intentional misrepresentation (first) and gross negligence in misrepresentation (second). Both causes of action arise from plaintiffs' central allegation in this action, that defendants fraudulently induced plaintiffs to invest in the partnerships in order to rid themselves of devalued properties at plaintiffs' expense.

Specifically, plaintiffs allege that defendants stated that their strategy for acquiring investment properties would be to "monitor changing economic conditions, anticipate the impact on real estate markets and act quickly and decisively on compelling investment opportunities." Plaintiffs allege that defendants failed to inform them that the investment properties had already been purchased at prices much higher than current market value, due to a precipitous decline in the real estate market. As such, plaintiffs allege that defendants' real goal was to pass their investment losses on to plaintiffs by selling the properties to LBREP III at the original acquisition cost plus 9%.

"To make a prima facie claim of fraud, a complaint must allege misrepresentation or concealment of a material fact, falsity, scienter on the part of the wrongdoer, justifiable

reliance and resulting injury." *Basis Yield Alpha Fund (Master) v Goldman Sachs Group, Inc.*, 115 AD3d 128, 135 (1st Dept 2014). CPLR 3016 (b) requires that, where a cause of action or defense is based upon fraud, the circumstances constituting the fraud must be stated in detail. In certain cases, the requirements of 3016 (b) "may be met when the facts are sufficient to permit a reasonable inference of the alleged conduct." *Pludeman v Northern Leasing Sys., Inc.*, 10 NY3d 486, 492 (2008) (citations omitted). Further, "corporate officers and directors may be held individually liable if they participated in or had knowledge of the fraud, even if they did not stand to gain personally." *Id.* (citation omitted).

As a threshold matter, I find that the complaint fails to allege any specific misrepresentations or omissions by any of the individual defendants in their individual capacities sufficient to sustain a cause of action for fraud. Therefore, the first and second causes of action are dismissed against the individual defendants on that basis.

Defendants also move to dismiss the fraud causes of action on the ground that the amended complaint fails to adequately allege the element of scienter in the factual detail required by CPLR 3016 (b). Plaintiffs rely on several items of circumstantial evidence to support their fraud causes of action.

First, they contend that a rational basis exists for inferring fraudulent scienter on the part of defendants because the LBREP III interests were being marketed to Lehman

clients at the same time that Lehman was writing off the value of its commercial real estate property portfolio across the board. Essentially, they argue that because Lehman was writing down the value of its overall real estate portfolio in October 2007, the value of the LBREP III properties must have been falling as well and defendants must have been aware of that fact.

Plaintiffs' argument is unpersuasive. The amended complaint sets forth no facts to demonstrate that defendants knew that the specific properties at issue here had decreased in value. *See Fried v Lehman Bros. Real Estate Associates III, L.P.*, 506 Fed Appx at 8. Even assuming that Lehman's overall portfolio had decreased in value due to a downturn in the market, plaintiffs put forth no case law to demonstrate that a general downturn in the market supports an inference of fraudulent scienter. *See Fried v Lehman Brothers Real Estate Associates III, L.P.* 2011 WL 1345097 at *8, 2011 US Dist Lexis 40431 at *24, (internal quotation marks and citations omitted) ("General knowledge about market conditions or trends does not equate to harboring a mental state to deceive, manipulate, or defraud").

Further, as set forth above, it is undisputed that the first supplement to the PPMs, which was distributed in November 2007, disclosed the identities of the investment properties that were being considered for transfer to the partnerships, including most of the properties that eventually were transferred. This supplement provided, among other

things, descriptions of the properties, the amount invested in each property and the dates on which Lehman received approval to invest in each property. Plaintiffs cannot now allege that they were not informed that certain properties had been purchased, or were being considered for purchase, or that they were not informed of the details of such transactions.

Plaintiffs assert that scienter may be inferred from several other facts. Specifically, they allege that defendants: 1) gave no notice of the May 28th property sales to LBREP III and resulting losses to investors until December 5, 2008; (2) failed to issue any 2nd Quarter 2008 financial statements under GAAP, which would have revealed the investors' losses; (3) gave investors a non-GAAP "Valuation Summary," claiming that LBREP III's portfolio had increased in value by 2.4%; and (4) waited until December 5th, 2008 to issue GAAP-based financial statements for LBREP III which revealed a 30% drop in value compared to the LBREP III purchase price.

The parties dispute whether the Valuation Summary relied on by plaintiffs was sent to investors or whether it was a purely internal Lehman document. However, in either event, this document does not support an inference of fraudulent scienter on defendants' part. As found in the federal court decisions related to this action, this document actually undermines an inference of fraudulent scienter because it indicates that

defendants did not believe that the value of the LBREP III portfolio had declined in value.

I find that, even assuming the truth of plaintiffs' other allegations with respect to the financial statements, the facts listed above do not support an inference of fraudulent scienter in inducing plaintiffs to invest in LBREP III. As noted in the federal action, each of these allegations involve actions that took place after all of the plaintiffs had already invested in LBREP III. Thus, they were not part of a "ploy to induce investment." *Fried v Lehman Bros. Real Estate Associates III, L.P.*, 506 Fed Appx at 9.

Plaintiffs also argue that an inference of scienter may be drawn from defendants' failure to appoint an Independent Advisory Committee (IAC), as promised in the PPMs, to review conflicts of interest or to consult on write downs, until after the transfer of properties on May 28, 2008. However, as noted in the federal court action, and as conceded by plaintiffs here, the PPMs did not set forth a deadline for the creation of an IAC and did not state that such a committee would be formed before the properties were transferred. Even assuming that such a committee was not formed before May 28, 2008, that fact does not support an inference of fraudulent conduct on the part of defendants in inducing plaintiffs to invest in LBREP III because there was no promise by defendants to do so. In fact, as noted in the Second Circuit decision,

> the partnership agreements did not require the defendants to consult with the Investor Advisory Committees regarding purchases of property interests from Lehman. Consequently, even if the Committees had already been appointed, the defendants could have entirely avoided the Committees' participation in the May 28, 2008, transaction.

Fried v Lehman Bros. Real Estate Associates III, L.P., 506 Fed Appx at 9.

Based on the foregoing, I find that plaintiffs have failed to allege sufficient facts upon which an inference of fraudulent scienter can be drawn on the part of any of the defendants. Therefore, the first and second causes of action are dismissed.

<u>Breach of Fiduciary Duty</u>

Plaintiffs' third, fourth, fifth and sixth causes of action allege claims for breach of fiduciary duty.

In the third cause of action, plaintiffs allege that defendants breached their fiduciary duties by failing to disclose that investors would lose value by inheriting Lehman's properties because the fair value of the properties to be acquired by LBREP III was substantially less than the purchase prices.

Even assuming, for the purposes of this motion, that defendants owed a fiduciary duty to plaintiffs, the complaint fails to state a cause of action with respect to plaintiffs' allegation that defendants misled them as to the value of the properties being sold to LBREP III. As set forth above, the PPMs and the Supplements thereto provided plaintiffs

with notice as to the properties that were being considered for transfer to LBREP III and the prices at which they had been purchased.

The third cause of action also alleges that defendants failed to obtain the informed consent of LBREP III investors prior to transferring properties to the limited partnerships in transactions. However, plaintiffs fail to allege that such consent was required under the LPA. Moreover, even if adequately alleged, such a cause of action would be for breach of contract, *i.e.*, breach of the LPAs, and a cause of action for breach of fiduciary duty would be duplicative. *See Celle v Barclays Bank P.L.C.*, 48 AD3d 301, 302 (1st Dept 2008).

The complaint further alleges that defendants failed to form an IAC as required by the PPMs and LPAs prior to the May 28, 2008 property transactions, to be able to consult on issues of conflicts of interest between Lehman and LBREP III and on appropriate valuations of properties to be transferred. As noted above, and in the federal court action, and as conceded by plaintiffs here, the PPMs did not set forth a deadline for the creation of an IAC and did not state that such a committee would be formed before the properties were transferred. In any event, here again that allegation would only support a cause of action for breach of contract and a cause of action for breach of fiduciary duty would be duplicative. *See id.* at 302.

Finally, in the third cause of action plaintiffs allege that defendants failed to disclose the contents of any "side letters" entered into with other limited partners. The LPAs permitted side letters and plaintiffs have not pointed to any section in the LPAs which required disclosure of the content of such side letters. Further, as above, such a cause of action would be for breach of contract and a cause of action for breach of fiduciary duty would be duplicative. *See id.* Accordingly, the third cause of action is dismissed in its entirety.

Plaintiffs allege in the fourth cause of action that defendants breached the LPAs by failing to obtain consent from either investors or from a duly formed IAC before purchasing the Lehman properties. First, this cause of action is one for breach of contract, not for breach of fiduciary duty. Moreover, the complaint fails to demonstrate that the defendants were required to obtain consent from the investors before completing the May 28, 2008 purchase of the Lehman properties.

With respect to the failure to form an IAC and obtain its consent, the Second Circuit decision noted that "the partnership agreements did not require the defendants to consult with the Investor Advisory Committees regarding purchases of property interests from Lehman. Consequently, even if the Committees had already been appointed, the defendants could have entirely avoided the Committees' participation in the May 28,

2008, transaction." *Fried v Lehman Bros. Real Estate Associates III, L.P.*, 506 Fed Appx at *9.

In the fifth cause of action, plaintiffs allege that, in February 2010, the individual defendants began a campaign to acquire Lehman's interest in the management business of the General Partner from the bankruptcy estate. They allege that defendants sought to obtain the consent of the LBREP III partners to amend the LPAs to create a Ninth Limited Partnership Agreement and to approve a new Investment Advisory Agreement with defendants' new company, LegacyCo Advisors, which was later renamed Silverpeak. The Ninth LPA was allegedly designed to increase defendants' management fees and, as such, the LBREP III partners were asked to vote on a proposal for these additional management fees.

Plaintiffs allege that the voting process was tainted in numerous ways with the result that it was difficult to vote against the proposal. Among other things, they allege that the proposal was sent by email rather than by regular mail, even though many of the partners' email addresses were no longer valid. They also allege that defendants refused to count ballots to which a "No" or "No consent" box had been added by voting partners. Defendants also allegedly refused to count ballots returned by email, despite the fact that the election materials had been sent by email. Plaintiffs further allege that the consent form was hidden at page 13 of a 100+ page document and they allege that "Defaulting

Partners" were not allowed to vote, despite the fact that the Ninth LPA would reduce the distributable proceeds payable to them, making their consent mandatory under the existing LPAs.

As above, this cause of action is properly one for breach of contract, not for breach of fiduciary duty. Even if was pled as a breach of contract claim, these allegations are deficient. First, the parties dispute whether the LPAs permitted the proposal to be sent by email rather than by regular mail. In either event, assuming that the proposals were sent by email, the amended complaint fails to allege that any of the plaintiffs here (as opposed to other, unnamed limited partners) did not receive the proposal or were injured by it being sent by email. The amended complaint also fails to allege any actual facts supporting the conclusory allegation that the defendants did not count votes against the proposal or those returned by email. Plaintiffs fail to adequately allege how the consent voting was hidden, particularly because defendants have shown that the consent and the expedited time frame of the election were prominently mentioned on the front page of the proposal. It is also undisputed that the LPAs permitted the General Partner to exclude defaulting partners from participating in the elections.

Finally, although plaintiffs object to the increase in the fees sought in the proposed Ninth LPA, the complaint fails to allege that plaintiffs and other limited partners were not

informed of such proposed fees before the vote which approved such fees. Therefore, the fifth cause of action for breach of contract is dismissed.

Plaintiffs' sixth cause of action alleges breaches of the LPAs in connection with management fees. LPA section 7.3 required each limited partner to pay a prescribed management fee to the General Partner for the period between the "Initial Closing" and the date of the "Final Distribution."

Plaintiffs allege that defendants breached the LPAs by calculating the amount of the management fees based on an Initial Closing date of October 1, 2007. They allege that the actual initial closing took place two months later, on November 30, 2007, when investors had signed subscriptions and were accepted as limited partners.

Plaintiffs' argument is unpersuasive. Once again, this cause of action is properly one for breach of contract, not for breach of fiduciary duty. In any event, the LPAs specifically provide that the Initial Closing date was October 1, 2007. Therefore, this portion of the complaint is dismissed.

Plaintiffs also allege that, in September 2009, defendants breached their fiduciary duty by wrongfully seeking to collect management fees for the period from January 1, 2009 to June 30, 2009. Plaintiffs allege that in February, 2009, defendants voluntarily reduced the amount of management fees applicable to the period in question. Defendants do not dispute that they temporarily reduced the amount of fees applicable to that period

of time. However, they argue that this was not a waiver of their right to later collect additional fees for that period.

"A waiver, by definition, is the intentional relinquishment of a known right — it must be clear, unequivocal and deliberate." *Silverman v Silverman*, 304 AD2d 41, 46 (1st Dept 2003) (internal quotation marks and citations omitted). Plaintiffs acknowledge that the original Capital Demand and Management Fee Notice, which was sent to the limited partners on February 6, 2009, stated that *"[a]t this time*, the General Partner is not calling Management Fees associated with Unfunded Capital Commitments pending finalization of the sale process." (Emphasis added) Thus, the original notice plainly stated that the fees at issue here were not being required "at this time," but said nothing about waiving the fees.

Plaintiffs' allegation of waiver arises from a February 23, 2009 follow-up Memorandum sent by the General Partner with information regarding a capital call made on February 6, 2009. In that Memorandum, defendants stated that management fees for the relevant period had been calculated "based only on total committed capital in respect of current Portfolio Investments rather than on . . . . full Capital Commitment." It further stated that "[a]s a result, the General Partner has significantly reduced, on a voluntary basis, the Management Fees that would otherwise be payable." As the documents plainly show, defendants took a voluntary reduction in management fees *at the time,* but

plaintiffs have not allege facts demonstrating a clear and unequivocal waiver of the right to collect additional fees at a later time.

Finally, the amended complaint alleges that defendant LBREA III breached its fiduciary duty by breaching its obligation under section 3.1 of the LPAs. This section stated, in relevant part, that if the General Partner determined that a change in business conditions had occurred, making a termination of the Commitment Period[1] necessary or advisable, the General Partner was required to cancel outstanding capital commitments to the extent that there were existing unfunded capital commitments. Upon that occurrence, the Commitment Period would terminate. Such a termination would affect the amount of management fees to be paid by the limited partners.

Plaintiffs allege that the Lehman bankruptcy in September 2008 and the decline of the commercial real estate market constituted a change in business conditions which required termination of the commitment period nine months earlier than its actual termination. Defendants seek dismissal of this claim on the ground that such a determination was within its discretion and, therefore, not subject to challenge by plaintiffs.

---

[1] The Commitment Period was defined as commencing as of the Initial Closing and ending on the fourth anniversary of the Initial Closing, or on an earlier expiration date as defined in the LPAs.

Plaintiffs concede that determining whether a change in business conditions had occurred, requiring an earlier termination of the Commitment Period, was within the discretion of defendants. Plaintiffs contend that defendants' failure to make such a determination was done in bad faith. However, the complaint fails to set forth any facts to support such an allegation, thus I dismiss this cause of action.

Declaratory Relief

Plaintiffs' seventh, eighth, ninth, tenth and eleventh causes of action seek declaratory relief in connection with various provisions of the LPAs.

The seventh cause of action seeks a declaration from the court with respect to the issue of whether defendants waived the right to collect additional management fees, as discussed above. Based on the dismissal of that claim, the seventh cause of action is dismissed.

Plaintiffs' eighth, ninth and tenth causes of action allege that certain provisions of the LPAs constituted unconscionable forfeitures and penalties. Specifically, plaintiffs allege that section 9.7 of the LPAs provided certain of the defendants with an improper, discretionary right to deem each LBREP III investor a "Defaulting Partner" and declare a forfeiture of 50% of his or her capital account if the partner failed or refused to timely pay a capital contribution demanded by said defendants, failed to timely pay a management

fee upon demand or failed to timely pay a management fee after termination of the Commitment Period.

Plaintiffs allege that these provisions are unconscionable and violate public policy. Defendants argue that Delaware law applies and that under Delaware law the provision at issue would not be considered unconscionable. Plaintiffs disagree that Delaware law applies, and argue that a New York court would not enforce the provisions at issue under New York public policy.

The parties have not fully briefed the issue of whether New York or Delaware law applies. However, I find that under either state's laws this cause of action must be dismissed. In Delaware, "it is generally held that the unconscionability test involves the question of whether the provision amounts to the taking of an unfair advantage by one party over the other." *Reserves Management, LLC v American Acquisition Property I, LLC*, 86 A3d 1119, *9 (Del 2014) (internal quotation marks and citation omitted). Moreover, "mere disparity between the bargaining powers of parties to a contract will not support a finding of unconscionability." *Id.* "For a contract clause to be unconscionable, its terms must be so one-sided as to be oppressive." *Id.* (internal quotation marks and citation omitted).

In New York, "[a]n unconscionable contract has been defined as one which is so grossly unreasonable or unconscionable in the light of the mores and business practices of

the time and place as to be unenforcible according to its literal terms." *Gillman v Chase Manhattan Bank,* 73 NY2d 1, 10 (1988) (internal quotation marks and citation omitted). "A determination of unconscionability generally requires a showing that the contract was both procedurally and substantively unconscionable when made — i.e., some showing of an absence of meaningful choice on the part of one of the parties together with contract terms which are unreasonably favorable to the other party." *Id.* (internal quotations marks and citations omitted).

Here, I find that plaintiffs have not adequately alleged that the provisions at issue were unconscionable under either New York or Delaware law. First, plaintiffs have failed to allege or demonstrate that, at the time plaintiffs decided to enter into subscription agreements, the plaintiffs lacked bargaining power or that they had no meaningful choices. In fact, it is undisputed that the PPMs disclosed that a party who failed to make required fundings under the LPAs could be declared in default and required to forfeit 50% of their capital account. In light of such disclosure, plaintiffs could have simply declined to invest in the first instance.

Moreover, the events at issue, involving defaults arising from failing to make a capital contribution or pay management fees, were important elements of the contract which were known to both parties from the outset. The complaint sets forth no facts to demonstrate that these provisions are so grossly unreasonable or oppressive as to be

unconscionable and unenforceable. Therefore, I dismiss the eighth, ninth and tenth causes of action.

Plaintiffs' eleventh cause of action alleges that, for the period following the termination of the Commitment Period on July 9, 2009, *i.e.*, the Expiration Date, defendants, after deeming a limited partner to be in default, continued to demand a management fee based on 1% or 1.75% of unreturned Capital Contributions, unreduced by the 50% forfeiture of the partner's Capital Account which resulted from such default, as described above.

Plaintiffs contend that, as defendants purported to have reduced the Capital Accounts of Defaulting Partners by a 50% forfeiture, the amount of their unreturned Capital Contributions was also reduced by 50%, and thus, the Management Fees payable by them must also be reduced by 50%. They assert that this is true because, by taking the 50% forfeitures, defendants asserted a right to return to defaulting partners on Final Distribution only half of the Capital Accounts such partners would otherwise have been entitled to except for the declaration of their default.

The LPAs defined Capital Contributions as "[w]ith respect to any Partner, at any time, the amount of capital actually contributed to the Partnership by such Partner." It is also undisputed that section 7.3 of the LPAs provided that, for "the period commencing upon the Expiration Date through the date of the Final Distribution, the Management Fee

payable by each Limited Partner shall equal 1.75% of such Limited Partner's unreturned Capital Contributions in all Portfolio Investments."

Thus, the LPAs clearly provide that the management fees at issue here were to be calculated based on the amount of a given partner's unreturned Capital Contributions. Plaintiffs point to no provision in the LPAs which required the amount of such unreturned contributions to be reduced by, or take into account, any amount that the partner forfeited on due to its own default.

Breach of Contract/Good Faith and Fair Dealing

Plaintiffs' twelfth cause of action is for breach of contract. The complaint alleges simply that defendants breached the LPAs by the various acts of fraud and misrepresentation, omission, gross negligence and breaches of fiduciary duty alleged in the other causes of action in the complaint. However, the complaint alleges no additional breaches other than those set forth in the various causes of action which have been disposed of above. Therefore, this cause of action is dismissed.

The thirteenth cause of action in the amended complaint is for breach of the implied covenant of good faith and fair dealing. A claim for breach of the implied covenant of good faith and fair dealing is properly dismissed as duplicative of a breach of contract claim when both claims arise from the same facts. *Feld v Apple Bank for Sav.*, 116 AD3d 549 (1st Dept 2014); *Logan Advisors, LLC v Patriarch Partners, LLC*, 63

AD3d 440, 443 (1st Dept 2009). Here, the factual allegations underlying this cause of action are duplicative of the allegations underlying plaintiffs' breach of contract cause of action in that plaintiffs once again assert that defendants breached various provisions of the LPAs, as described above, which I have already addressed. Therefore, the thirteenth cause of action is dismissed.

Aiding and Abetting Fraud and Breach of Fiduciary Duty

Plaintiffs' fourteenth cause of action is for aiding and abetting fraud and breaches of fiduciary duty against Walsh, Bossung, Newman, Amboss, Dinnie, Fuld, Gregory, O'Meara, Odrich, Callan, Russo, and Littow. The complaint alleges, in a conclusory manner, that each of the individual defendants had knowledge of the fraudulent misrepresentations and omissions set forth above, with respect to the sale of the partnership interests to plaintiffs, and with respect to the true value of the properties.

The complaint does not adequately set forth specific factual allegations against the individual defendants or otherwise distinguish among them with respect to specific conduct, such as would support a cause of action against a given individual. The only specific conduct in the complaint is the allegation that Odrich sent a letter to plaintiffs on March 18, 2008, which warned investors that the real estate market was under unprecedented stress, but assured them that Lehman remained confident about its ability

to provide good investment returns. Plaintiffs have not put forth any facts or otherwise demonstrated that the statements in the letter are actionable.

In any event, the causes of action underlying the aiding and abetting claim have been dismissed, as set forth above. Therefore, the fourteenth cause of action is also dismissed.

Civil Conspiracy

Plaintiffs' fifteenth cause of action is for civil conspiracy. However, civil conspiracy is not recognized as an independent tort in New York. *Mamoon v Dot Net Inc.*, 135 AD3d 656, 658 (1st Dept 2016), citing *Shared Communications Servs. of ESR, Inc. v Goldman Sachs & Co.*, 23 AD3d 162, 163 (1st Dept 2005). Therefore, the fifteenth cause of action is dismissed.

Derivative Claim

The sixteenth cause of action in the amended complaint asserts a derivative claim on behalf of LBREP III, in the event that the remainder of the amended complaint is dismissed. However, the amended complaint sets forth facts to support claims of alleged injuries to the individual plaintiffs as investors. It sets forth no facts to demonstrate a cause of action on behalf of the partnerships themselves. Therefore, this cause of action is dismissed.

Accordingly, it is

ORDERED that the motion to supplement the record by defendants Lehman Brothers Real Estate Associates III L.P., Lehman Brothers Private Equity Advisers, LLC, and Real Estate Private Equity. Inc. is granted and it is further

ORDERED that the motion by defendants Lehman Brothers Real Estate Associates III L.P., Lehman Brothers Private Equity Advisers, LLC, Real Estate Private Equity, Inc., Michael J. Odrich, Christopher M. O'Meara, Richard J. Fuld, Jr., Joseph M. Gregory, Erin Callan, Ian Lowitt and Thomas Russo, to dismiss the amended complaint (sequence 003), is granted and the amended complaint is dismissed as against them; and it is further

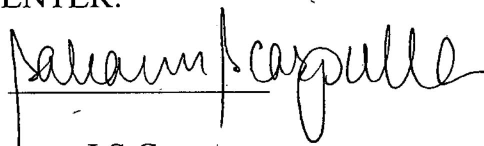
ORDERED that the motion by defendants Mark A. Walsh, Mark H. Newman, Brett Bossung, Rodolpho Amboss, Kevin Dinnie, Silverpeak Real Estate Partners, LP, and REPE CP ManageCo, LLC, to dismiss the amended complaint (sequence 004), is granted and the amended complaint is dismissed as against them; and it is further

ORDERED that the Clerk of the Court is directed to enter judgment accordingly.

This constitutes the decision and order of the Court.

DATED: 8|5|16

ENTER:



J.S.C.