| **Storper v WL Ross & Co., LLC** |
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| 2018 NY Slip Op 32235(U) |
| September 5, 2018 |
| Supreme Court, New York County |
| Docket Number: 656932/2017 |
| Judge: Andrea Masley |
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SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK : IAS PART 48

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DAVID H. STORPER, DAVID L. WAX, and PAMELA K. WILSON, derivatively on behalf of WLR RECOVERY ASSOCIATES II, LLC, WLR RECOVERY ASSOCIATES III, LLC, and WLR RECOVERY ASSOCIATES IV, LLC,

Plaintiffs,

-against- Index No. 656932/2017

WL ROSS & CO., LLC, WL ROSS GROUP, L.P., and WILBUR L. ROSS,

Defendants.

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**Masley, J.**

Defendants WL Ross & Co. LLC (WL Ross), WL Ross Group, L.P. (WL Ross Group), and Wilbur L. Ross (Ross) move, pursuant to CPLR 3211 (a) (1) and (a) (7), for an order dismissing with prejudice the first amended complaint in its entirety.

In this derivative action, plaintiffs David H. Storper, David L. Wax, and Pamela K. Wilson, former WL Ross senior-level employees, sue on behalf of WLR Recovery Associates II, LLC (WLR II), WLR Recovery Associates III, LLC (WLR III), and WLR Recovery Associates IV, LLC (WLR IV) (collectively, GPs), the general partners of three private equity funds, non-parties WLR Recovery Fund II, L.P. (Fund II), WLR Recovery Fund III, L.P. (Fund III), and WLR Recovery Fund IV, L.P. (Fund IV) (collectively, Funds). The GPs are Delaware limited liability corporations and the Funds are Delaware limited partnerships.

Plaintiffs allege that WL Ross is an investment advisor limited liability company which manages various investment vehicles, including private equity funds such as the Funds, usually structured as partnerships containing a general partner and limited partners. Plaintiffs also allege that, until February 17, 2017, Ross was the chairman and chief executive officer of WL Ross Group, a New York limited partnership and managing member of the GPs, until it was succeeded

in that capacity by WL Ross, also on February 17, 2017.

Plaintiffs allege that, while employed by WL Ross, they made significant personal investments in the GPs and performed the management functions that the GPs were required to provide to the Funds. Plaintiffs further allege that, pursuant to the terms of the amended and restated limited partnership agreements [LPAs] executed by the Funds and the GPs, plaintiffs' investments and management services entitled them to share in the profits and carried interest that the GPs received from the Funds, and obligated them to share in any losses incurred by the GPs.

Plaintiffs allege that defendants, as the current and former managing members of the GPs during the relevant time period, improperly utilized their control over the GPs and breached the fiduciary duties that they owed to the GPs and the non-managing members by siphoning away more than $48 million in improper and unreasonably high management fees charged to the GPs, by taking those fees for themselves, and by intentionally concealing their misconduct from the GPs' non-managing members. Plaintiffs allege that Fund II paid fees to WLR II, Fund III paid fees to WLR III, and Fund IV paid fees to a designated management company. Plaintiffs allege that, in addition, WL Ross breached its fiduciary duty by receiving those management fees.

On those allegations, plaintiffs assert three causes of action for an equitable accounting of the GPs' finances and restitution or disgorgement of the alleged improper management fees. Plaintiffs also seek to permanently restrain WL Ross, and any affiliate under its control, from allowing management fees to be charged to the GPs, together with other, related relief.

Defendants now seek to dismiss the first amended complaint in its entirety.

As a threshold matter, the court notes that the law of this state applies to the procedural issues raised here, and that Delaware law applies to the substantive issues raised in this action

relating to the GPs (*see Portfolio Recovery Assoc., LLC v King*, 14 NY3d 410, 416 [2010]), in accordance with the LPAs' choice of law provisions (*see* Fund II LPA § 21.08; Fund III LPA § 21.08; Fund IV LPA § 21.08).

On a motion addressed to the sufficiency of the pleadings, the court must accept each and every allegation in the complaint as true, and liberally construe those allegations in the light most favorable to the pleading party (*Leon v Martinez*, 84 NY2d 83, 87-88 [1994]; *see* CPLR 3211 [a] [7]). The court determines "only whether the facts as alleged fit within any cognizable legal theory" (*Leon v Martinez*, 84 NY2d at 87-88).

However, "allegations consisting of bare legal conclusions, as well as factual claims either inherently incredible or flatly contradicted by documentary evidence, are not presumed to be true and [are not] accorded every favorable inference" (*Biondi v Beekman Hill House Apt. Corp.*, 257 AD2d 76, 81 [1st Dept 1999], *affd* 94 NY2d 659 [2000] [internal quotation marks and citation omitted]; *David v Hack*, 97 AD3d 437, 438 [1st Dept 2012]; *see* CPLR 3211 [a] [1]). Allegations in conclusory form, based upon information and belief, do not establish a sufficient factual showing evidentiary in nature to support a claim (*Lewis v Riklis*, 82 AD2d 789, 789 [1st Dept 1981]).

Defendants contend that plaintiffs are not entitled to an equitable accounting, on the grounds that an adequate remedy at law is available and that the alleged misconduct, even if proven, does not constitute a breach of fiduciary duty.

In opposition, plaintiffs contend that defendants have mischaracterized the gravamen of this action as one sounding in contract, rather than tort, and that, defendants, as managing members of the GPs, owe plaintiffs, as non-managing members, fiduciary duties and have breached those duties by charging, receiving, and retaining, improper management fees and by

intentionally failing to disclose such misconduct.

Plaintiffs have failed to plead facts sufficient to support a legally viable claim for an equitable accounting. "To be entitled to an equitable accounting, a claimant must demonstrate that he or she has no adequate remedy at law" (*Unitel Telecard Distrib. Corp. v Nunez*, 90 AD3d 568, 569 [1st Dept 2011]; *Soley v Wasserman*, 639 Fed Appx 670, 674 [2d Cir 2016]; *see International Bus. Mach. Corp. v Comdisco, Inc.*, 602 A2d 74, 78-79 [Del Ch 1991]). "The right to an accounting is premised upon the existence of a confidential or fiduciary relationship and a breach of the duty imposed by that relationship respecting property in which the party seeking the accounting has an interest" (*Palazzo v Palazzo*, 121 AD2d 261, 265 [2d Dept 1986]; *see Weinstein v Natalie Weinstein Design Assoc., Inc.*, 86 AD3d 641, 643 [1st Dept 2011]).

In the amended complaint, plaintiffs allege that defendants breached certain fiduciary duties by improperly paying, causing to be paid, receiving, or retaining management fees and by not disclosing such fees to plaintiffs. Thus, the damages allegedly suffered by plaintiffs are clearly monetary. Therefore, plaintiffs could be made whole by an award of monetary damages. Where monetary damages are available and will make the plaintiff whole, the plaintiff has an adequate remedy at law (*see Romanoff v Romanoff*, 148 AD3d 614, 616 [1st Dept 2017]; *International Bus. Mach. Corp. v Comdisco, Inc.*, 602 A2d at 78-79]). Thus, plaintiffs' factual allegations, if proven, demonstrate that plaintiffs have an adequate remedy at law, and, therefore, are not entitled to an equitable accounting.

The court notes that plaintiffs are entitled by the terms of the amended and restated limited liability corporation agreement (LLCA) for each GP to fully inspect and audit the GP's financial books and records, including its bank balances (*see* WLR II LLCA § 16 [b]; WLR III LLCA § 16 [b]; WLR IV LLCA § 16 [b]). Therefore, the financial information for each GP may

be obtained through pre-trial discovery if not produced as required by the LLCA.

Contrary to plaintiffs' contention, the mere allegation of the existence of a fiduciary duty, without more, does not entitle them to an equitable accounting. A plaintiff must also demonstrate that he or she has no adequate remedy at law before a court may award an equitable accounting (*Soley v Wasserman*, 639 Fed Appx at 674).

To the extent that the plaintiffs allege claims for breach of fiduciary duties, those claims are fatally defective on the ground that the claims arise entirely out of alleged breaches of contractual, rather than fiduciary, obligations.

The law governing a fiduciary duty claim is based on the internal affairs doctrine, which applies the law of the state of incorporation (*see Levinton Mfg. Co. v Blumberg*, 242 AD2d 205, 207 [1st Dept 1997]). Therefore, Delaware law governs this issue.

Pursuant to Delaware law, a managing member owes equitable fiduciary duties by default, unless altered by the LLC operating agreement (*Feeley v NHAOCG, LLC*, 62 A3d 649, 660-661 [Del Ch 2012]). Delaware law, thus, "respects the primacy of contract law over fiduciary law in matters involving . . . contractual rights and obligations and does not allow fiduciary duty claims to proceed in parallel with breach of contract claims unless there is an independent basis for the fiduciary duty claims apart from the contractual claims" (*The Renco Group Inc. v MacAndrews AMG Holdings LLC*, 2015WL394011, *7, 2015 Del Ch LEXIS 25, *24-25 [Del Ch 2015] [internal quotation marks omitted]). It is a well established principle under Delaware law "that where a dispute arises from obligations that are expressly addressed by contract, that dispute will be treated as a breach of contract claim. In that specific context, any fiduciary claims arising out of the same facts that underlie the contract obligations would be foreclosed as superfluous" (*Nemec v Shrader*, 991 A2d 1120, 1129 [Del 2010]).

Contrary to plaintiffs' contention that they are not bound by the LPAs because they are not, individually, partners in Funds II, III, and IV, and did not execute the LPAs in their individual capacities, they are bound by all defenses applicable against the GPs. Plaintiffs commenced this action in their derivative capacities, on behalf of the GPs. In a derivative action, the plaintiff stands in the shoes of the corporation, and, therefore, its rights are limited to the rights of the corporation, and it is subject to all defenses that would apply against the corporation (*see Nationwide Mut. Ins. Co. v U.S. Underwriters Ins. Co.*, 151 AD3d 504, 505 [1st Dept 2017]).

Here, the GPs' obligations to pay, or to receive, management fees expressly arise from the terms of the LPAs (*see* Fund II LPA § 5.03; Fund III LPA § 5.03; Fund IV LPA § 5.03), and defendants' obligations, if any, to pay management fees to the GPs arise from the terms of the LLCAs (*see* WLR II LLCA § 4 [e]; WLR III LLCA § 4 [e]; WLR IV LLCA § 4 [e]). Plaintiffs' allegations that defendants' conduct was contrary to the "universal industry practice" (*see e.g.* amended complaint, ¶ 62) are directly contradicted by those terms.

Defendants' obligation to disclose financial statements and related information to plaintiffs similarly arises from the express terms of the LLCAs (*see* WLR II LLCA § 16; WLR III LLCA § 16; WLR IV LLCA § 16). Therefore, any claim arising out of allegations that defendants failed to provide plaintiffs with financial information is, at most, a breach of contract claim and does not constitute a viable fiduciary duty claim.

Moreover, the exculpatory provision set forth in each LLCA shields defendants from liability for the breaches as alleged by plaintiffs. The provision provides, in relevant part, that:

> "[T]he Controlling Members and their respective Affiliates shall not be liable to the Company or any Member for any loss suffered by the Company or by any Member which arises out of any investment or any action taken or omission suffered by such Controlling Member without gross negligence or a willful disregard of his or her duties"

(WLR II LLCA § 4 [h]; WLR III LLCA § 4 [g]; WLR IV LLCA § 4 [g]). The provision also provides that "[T]he Controlling Members shall exercise their best judgment in making investments for the Fund, managing the activities of the Fund and the Company, and in carrying out their other obligations hereunder and under the Fund Partnership Agreement" (WLR II LLCA § 4 [h]; WLR III LLCA § 4 [g]; WLR IV LLCA § 4 [g]).

Pursuant to Delaware law, gross negligence "is conduct that constitutes reckless indifference or actions that are without the bounds of reason" (*McPadden v Sidhu*, 964 A2d 1262, 1274 [Del Ch 2008]).

The exculpatory provisions clearly include within their scope defendants' payment, or receipt, of management fees, and protect defendants against the claims and allegations of improper conduct asserted by plaintiffs.

To the extent that plaintiffs allege that defendants relied on professionals at WL Ross, including accounting, finance, and tax professionals, in executing their duties as the GPs' managing members, defendants are similarly protected by the exculpatory provisions. Under those provisions, a managing member is not liable for even intentional misconduct of such individuals (*see* WLR II LLCA § 4 [h]; WLR III LLCA § 4 [g]; WLR IV LLCA § 4 [g]).

In addition, the LLCAs provide that defendants cannot be held liable for engaging in activities that are "specifically authorized by or described in this Agreement, the Fund Partnership Agreement or the Management Agreement" (WLR II LLCA § 4 [h] [ii]; WLR III LLCA § 4 [g] [ii]; WLR IV LLCA § 4 [g] [ii]). "[T]he court is not required to accept factual allegations that are plainly contradicted by the documentary evidence or legal conclusions that are unsupportable based upon the undisputed facts" (*Robinson v Robinson*, 303 AD2d 234, 235 [1st Dept 2003]).

Defendants, as the GPs' managing members, are also protected by Delaware's business judgment rule. "The rule posits a powerful presumption in favor of actions taken by the directors in that a decision made by a loyal and informed board will not be overturned by the courts unless it cannot be attributed to any rational business purpose" (*Cede & Co. v Technicolor, Inc.*, 634 A2d 345, 361 [Del 1993] [internal quotation marks and citation omitted], *mod on other grounds* 636 A2d 956 [Del 1994]). Delaware's business judgment rule presumes 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" (*see In re Walt Disney Co. Deriv. Litig. v Eisner*, 906 A2d 27, 52 [Del 2006] [internal quotation marks and citation omitted]). Pursuant to that rule, a board of director's decisions are upheld so long as they can be attributed to any rational business purpose (*id.* at 74).

Significantly, the presumption cannot be overcome unless the plaintiff pleads specific facts demonstrating otherwise (*Crescent/Mach I Partners, L.P. v Turner*, 846 A2d 963, 984 [Del Ch 2000]).

Here, at most, plaintiffs allege that defendants misinterpreted and misapplied the LPAs' management fee provisions. Their allegations that defendants acted willfully and in bad faith are conclusory, and unsupported by any factual allegations (*see* amended complaint ¶¶ 86, 100, 114). Therefore, those allegations are insufficient to overcome the substantial protections accorded defendants by the relevant agreements and the presumptions of Delaware's business judgment rule.

The equitable accounting claims asserted against Ross or WL Ross Group are also fatally defective on the ground that, inasmuch as there is no dispute that neither remains a managing member of any GP, neither has the authority to provide the requested accounting.

Moreover, plaintiffs' factual allegations demonstrate that WL Ross did not owe any fiduciary duties to the GPs or their members until February 27, 2017, when it became the GPs' managing member, well after the Funds ceased paying management fees in 2010. Therefore, WL Ross could not have breached any fiduciary duty to the GPs or their members, or received management fees as a result of such breach, at any relevant time.

In addition, plaintiffs' claims against Ross or WL Ross Group are fatally defective on the ground that plaintiffs do not allege that either received any management fees from the GPs. Instead, plaintiffs allege that those fees were received by WL Ross (*see* amended complaint ¶ 65). Therefore, neither can be held liable for restitution or disgorgement of any such fees.

For the foregoing reasons, plaintiffs' claims are not legally cognizable. Therefore, defendants' motion to dismiss the amended complaint is granted in its entirety.

Accordingly, it is

ORDERED that defendants' motion is granted in its entirety, and the first amended complaint is dismissed as against all defendants, with costs and disbursements to defendants, as taxed by the Clerk of the Court, and the Clerk is directed to enter judgment accordingly in favor of each defendant.

Dated: September 5, 2018

ENTER:

J.S.C.

HON. ANDREA MASLEY