

IsZo Capital LLP. v Bianco

2018 NY Slip Op 33384(U)

December 26, 2018

Supreme Court, New York County

Docket Number: 650812/2018

Judge: Eileen Bransten

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SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK: IAS PART 3

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ISZO CAPITAL LLP., derivatively on behalf of
AMBASE CORPORATION

Plaintiff,

-against-

Index No. 650812/2018

Motion Seq. No. 01

RICHARD A. BIANCO; ALESSANDRA F. BIANCO
HALLORAN; RICHARD A. BIANCO, JR.; KENNETH
M. SCHMIDT; JERRY Y. CARNEGIE; JOHN
FERRARA; JOSEPH R. BIANCO

Defendant..

-----X

BRANSTEN, J.:

Defendants bring the instant motion to dismiss pursuant to CPLR 3211(a)(1) (documentary evidence), CPLR 3211(a)(3) (lack of capacity), and CPLR 3211(a)(7) (failure to state a cause of action). At the October 19, 2018 hearing the Court granted dismissal of this action as against Defendants Alessandra F. Bianco Halloran, Richard A. Bianco, Jr., Jerry Y. Carnegie, John Ferrara, and Joseph R. Bianco. *See* Tr. 9:11 – 13:2 (Debra Salzman, RMR) (October 19, 2018). The remainder of this decision concerns defendants Richard A. Bianco’s and Kenneth M. Schmidt’s Motion to Dismiss pursuant to CPLR 3211(a)(1) and CPLR 3211(a)(7).

I. BACKGROUND

IsZo is a limited partnership, organized under Delaware laws, and is a shareholder of Ambase Corporation. *See* Compl. ¶¶ 1, 17. Ambase is a Delaware corporation whose major asset is an equity investment in a joint venture with the 111 West 57th Sponsor (hereinafter “Sponsor”), a developer. *See* Compl. ¶¶ 27, 37. Ambase and sponsor were going to develop a

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luxury skyscraper at 111 West 57th Street in Manhattan (the “Project”). *See* Compl. ¶¶ 27, 37.

The Project was financed by a loan of \$725 million from a group of lenders and secured by a mortgage on the property. *See* Compl. ¶ 48. As of the date of the Complaint Ambase had contributed over \$66 million to the Project. *See* Compl. ¶ 41.

In late 2016, the \$725 million loan was “out of balance,” meaning the acquisition, construction, and carrying costs exceeded the value of the Project’s budget. *See* Compl. ¶ 50. Sponsor proposed a refinancing and sought approval from the Company, pursuant to the Joint Venture Agreement. *See* Compl. ¶ 50-53. Richard Bianco is alleged to have conditioned approval of refinancing on demands that he knew the Sponsor would not meet. Compl. ¶ 55. In addition, Plaintiff alleges Richard Bianco refused multiple offers to settle the Equity Put Right and refinance.¹ *See* Compl. ¶ 58.

In January 2017, Apollo, one of the lenders, issued a “Borrower’s Shortfall Contribution Notice,” demanding payment of \$62,966,853. *See* Compl. ¶¶ 63-64. After the deadline for paying the Shortfall Contribution passed, Sponsor negotiated a Forbearance Agreement, dated March 3, 2017, under which Apollo agreed to fund the Project for a limited time while the Sponsor sought refinancing. *See* Compl. ¶ 65. On June 30, 2017, however, the Forbearance Agreement expired, at which time the lender declared a default and proposed to accept full equity interest in the Project as satisfaction of the debt. *See* Compl. ¶¶ 68-69.

On July 25, 2017, Ambase filed a complaint in New York against the Sponsor and lender seeking to enjoin the foreclosure. The Court denied the motion for preliminary injunction and

¹ Equity Put Right refers to an enhanced payment right as against the Sponsor, which arose once the project exceeded the previously-approved budget by a certain amount. *See* Compl. ¶ 6.

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the lender now claims to own the Company's equity interest in the Project. Defendant Richard A. Bianco is President, CEO, and chairman of the Ambase's Board and Defendant Kenneth M. Schmidt has been a director of Ambase since 2013. *See* Compl. ¶¶ 18, 22. On September 26, 2017, the Company announced it had entered into a litigation funding arrangement with Richard Bianco and other Board Members, to fund continued litigation against the Sponsor and other lenders. Plaintiff subsequently commenced this action by Summons and Complaint filed February 16, 2018, alleging five causes of action for breach of fiduciary duty and declaratory judgment.

II. DISCUSSION

Defendants Richard A. Bianco and Kenneth M. Schmidt move to dismiss the Complaint pursuant to CPLR 3211(a)(1) and CPLR 3211(a)(7). The Court initially notes that the nominal Defendant, Ambase Corporation, is a Delaware Corporation with a principal place of business in Florida. *See* Comp. ¶ 27.

Because Ambase is a Delaware corporation, the court must apply New York's procedural standards to Delaware's substantive law. *See New Greenwich Litig. Tr., LLC v. Citco Fund Servs. (Europe) B.V.*, 145 A.D.3d 16, 22 (1st Dep't 2016), *leave to appeal denied*, 29 N.Y.3d 917 (2017) (stating that under the internal affairs doctrine, "claims concerning the relationship between the corporation, its directors, and a shareholder are governed by the substantive law of the state or country of incorporation").

"On a motion to dismiss pursuant to CPLR 3211, the pleading is to be afforded a liberal construction. We accept the facts as alleged in the Complaint as true, accord plaintiffs the

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benefit of every possible favorable inference, and determine only whether the facts as alleged fit within any cognizable legal theory.” *See Leon v. Martinez*, 84 NY2d 83, 87-88 (1994). Under CPLR 3211(a)(1), a dismissal is warranted “only if the documentary evidence submitted conclusively establishes a defense to the asserted claims as a matter of law.” *See id.* 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”. *See Biondi v. Beekman Hill House Apt. Corp.*, 257 A.D.2d 76, 81 (1st Dept 1999), *aff’d* 94 N.Y.2d 659 (2000); *David v. Hack*, 97 A.D.3d 437, 438 (1st Dept 2012); *see* CPLR 3211 (a)(1).

Plaintiff alleges Defendants Bianco and Kenneth M. Schmidt breached their fiduciary duties (counts 1, 2, 3) and seeks declaratory judgments (counts 4 and 5) concerning the rights of directors in the company. The Court initially notes that the action

A. Breach of Fiduciary Duty (Counts 1 - 3)

Under Delaware law, a claim for breach of fiduciary duty requires proof of two elements: (1) that a fiduciary duty existed and (2) that the defendant breached that duty. *See Beard Research, Inc. v. Kates*, 8 A.3d 573, 601 (Del. Ch. 2010), *aff’d* sub nom. *ASDI, Inc. v. Beard Research, Inc.*, 11 A.3d 749 (Del. 2010). A corporate officer or director unquestionably owes duties to the corporation. *See id.* A breach of that duty occurs when a fiduciary commits an unfair, fraudulent, or wrongful act. *Id.*

Here Plaintiff pleads three breaches of fiduciary duty. Plaintiff initially plead that Defendant Bianco breached his fiduciary duty of care by failing to consent to the West 57th Street

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refinancing. *See* Compl. ¶¶ 110 – 112. Bianco is then alleged to have breached his fiduciary duty of loyalty by virtue of his being on both sides of a litigation funding agreement, which benefitted him as well as the company. *See id* at ¶¶ 116 – 118. Defendant Schmidt is alleged to have breached his fiduciary duty of care by virtue of enabling Defendant Bianco’s continued failure to consent to refinancing, and enabling, countenancing, and approving the litigation funding agreement, without any meaningful effort to obtain funding from an unconflicted source. *See id* at ¶¶ 123, 124.

“Delaware has three tiers of review for evaluating director decision-making: the business judgment rule, enhanced scrutiny, and entire fairness.” *See Rural Metro Corp.*, 88 A.3d 54, 81–82 (Del. Ch. 2014), decision clarified on denial of reargument sub nom. *In re Rural Metro Corp. Stockholders Litig.* (Del. Ch. 2014). The business judgment rule is a “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. A hallmark of the business judgment rule is that a court will not substitute its judgment for that of the board if the latter’s decision can be attributed to any rational business purpose.” *See Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946, 954 (Del. 1985).

Enhanced scrutiny is Delaware’s intermediate standard of review and applies to “specific, recurring, and readily identifiable situations involving potential conflicts of interest where the realities of the decisionmaking context can subtly undermine the decisions of even independent and disinterested directors.” *See Rural Metro Corp.*, 88 A.3d at 82. Under the enhanced scrutiny doctrine, the defendant directors must establish “(i) the reasonableness of “the decisionmaking process employed by the directors, including the information on which the directors based their

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decision, and (ii) the reasonableness of the directors' action in light of the circumstances then existing.” *Id.*

Entire fairness, Delaware's strictest standard, applies when “the board labors under actual conflicts of interest. Once entire fairness applies, the defendants must establish to the court's satisfaction that the transaction was the product of both fair dealing and fair price. Not even an honest belief that the transaction was entirely fair will be sufficient to establish entire fairness. Rather, the transaction itself must be objectively fair, independent of the board's beliefs.” *See In re Trados Inc. S'holder Litig.*, 73 A.3d 17, 44 (Del. Ch. 2013). In order to obtain review under the entire fairness standard, however, plaintiff must “prove that there were not enough independent and disinterested individuals among the directors making the challenged decision to comprise a board majority.” *Id.*

1. Breach of the Fiduciary Duty as it Pertains to the 111 W. 57th Street Refinance

Plaintiffs allege Defendant Bianco failed to consent to refinancing the 111 W. 57th Street project, resulting in substantial litigation and loss to the company. *See* Compl. ¶¶ 50 – 62; 110 – 111. Specifically, the Complaint alleges that there was “no legitimate justification for [Bianco’s] linking” acquiescence to the refinancing with obtaining documents which would settle litigation concerning the equity put right provision of the agreement between Ambase and the Sponsor. *See* Comp. ¶57. There is no underlying allegation of bad faith or self-dealing insofar as the failure to consent to refinancing is concerned, and the Plaintiff’s conclusory assertion that the failure to consent was a breach of fiduciary duty. *Id.* at ¶¶ 50 – 63. In fact, there is nothing in the Complaint to indicate — and indeed the Plaintiff seems to concede — that

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this was nothing more than a business decision made by the board. *See e.g.* Comp. ¶62 (stating “to be clear this Complaint takes no position as to whether the out-of-balance condition was the fault of the Sponsor, and/or whether it was the responsibility of the Sponsor to cure the out-of-balance condition. Nor does this Complaint take the position that the Sponsor’s actions in connection with seeking the Company’s approval for the refinancing were appropriate.”)

Because allegations consisting of bare legal conclusions, and factual claims which are inherently incredible, “are not presumed to be true and [are not] accorded every favorable inference” the Court disregards the allegation that the business decision was made in bad faith. *See Biondi v. Beekman Hill House Apt. Corp.*, 257 A.D.2d 76, 81 (1st Dept 1999), *aff’d* 94 N.Y.2d 659 (2000). Given that the court must conclude the allegations relate to a good faith business decision of the board, the Court applies the business judgment rule. *See Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946, 954 (Del. 1985). Under the business judgment rule, the Court will not substitute its judgement for that of the board if the latter’s decision can be attributed to “**any** rational business purpose”. *See id* (emphasis added).

The Court therefore dismisses the claim for breach of the fiduciary duty of care as against Defendant Bianco and dismisses the claim for breach of the fiduciary duty of care, as it pertains to the refusal to consent to refinancing, against Defendant Schmidt.

2. Breach of Fiduciary Duty as it Pertains to the Litigation Agreement

Plaintiff alleges that Defendant Bianco breached his duty of loyalty by virtue of his entering into an agreement with Ambase whereby Bianco, a director in Ambase, would personally fund ongoing litigation between Ambase and parties connected to the 111 W. 57th

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Street Venture in exchange for a dollar for dollar recoupment of the litigation costs plus 30%-45% of any additional recovery amount. *See* Compl. ¶ 80. The litigation agreement is alleged to be inappropriate in four ways: (1) it is alleged to be unprecedented to enter into a litigation agreement with a senior board member; (2) the amount of compensation the defendant is expected to receive is clearly not in line with the market; (3) there is no legitimate rational for bypassing the market and entering into this interested transaction; (4) the Defendant is incentivized to allow litigation to proceed beyond 36 months in order to obtain a higher payout from the contract in the event Ambase is victorious. *See id* at ¶¶ 81 – 101.

Defendant Schmidt is alleged to have breached his fiduciary duty of care by enabling the transaction to occur without any meaningful effort to obtain litigation funding from an unconflicted source. *See id* at ¶124.

The Court notes that the Defendant's reliance on Delaware Corporate law for the premise "no contract or transaction between a corporation and 1 or more of its directors or officers . . . shall be void or voidable **solely** for this reason" does not conclusively establish whether there is some other legitimate reason to find the contract was improper. *See* 8 Del. Code § 144. Hence, Plaintiff has sufficiently alleged claims which preclude the court from applying the business judgment rule at the outset. *See Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946, 954 (Del. 1985). Instead the court must apply either an enhanced scrutiny or entire fairness test to determine if there was a breach of fiduciary duty. *See Rural Metro Corp.*, 88 A.3d at 83; *see also Trados Inc. S'holder Litig.*, 73 A.3d at 21. Under either test, the burden shifts to the directors to submit the requisite proofs to show that either the transaction was reasonable or that it was entirely fair. *Id.*

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Documents submitted in support of Defendants contentions consist of self-serving affidavits which are insufficient, on a motion to dismiss, for the “purposes of determining whether there is evidentiary support to dismiss a complaint.” *See Tsimerman v. Janoff*, 40 A.D.3d 242, 242 (1st Dep’t 2007). Therefore, the court finds that the Plaintiff has alleged sufficient facts to permit the claim for breach of the fiduciary duty of loyalty against Defendant Bianco (count 2) to remain as well as sufficient facts to permit the claim for breach of the fiduciary duty of care (count 3) as against Defendant Schmidt — both of which involve the purported self-dealing resulting from a conflicted litigation agreement — to remain.

B. Plaintiff’s Claims for a Declaratory Judgment (Counts 4 and 5)

Declaratory judgments are a means to establish the respective legal rights of the parties to a justiciable controversy. “The general purpose of the declaratory judgment is to serve some practical end in quieting or stabilizing an uncertain or disputed jural relation either as to present or prospective obligations. While fact issues certainly may be addressed and resolved in the context of a declaratory judgment action, the point and the purpose of the relief is to declare the respective legal rights of the parties based on a given set of facts, not to declare findings of fact.” *See Thome v. Alexander & Louisa Calder Found.*, 70 A.D.3d 88, 100 (1st Dep’t 2009).

Here Plaintiffs seek two declaratory judgments. The first seeks to have this court issue a declaration that the Litigation Funding Agreement is invalid. *See Comp.* ¶132. The second seeks to have the Court issue a declaration that any sale concerning the 111 West 57th Street Property rights (1) not be made to any entity in which the Defendant has

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interest, (2) be accompanied by the setting aside of the Litigation Agreement, such that proceeds of the sale will be distributed to the Company and its shareholders, (3) that none of the proceeds be allocated to pay off any consideration of the litigation funding agreement, (4) that the company give notice and full disclosure of the terms of any agreement to sell the 111 W. 57th Street Property interests, and (5) that the company shall not issue any sale without the approval of a majority of the voting shares of non-Bianco family members.

1. Whether the Litigation Agreement Should be Set Aside

Plaintiff argues that the litigation agreement should not be set aside as there is no justiciable controversy. *See* Defendant's Br. at 17. The thrust of Defendants' argument is that, under Delaware law, "no contract or transaction between a corporation and 1 or more of its directors or officers . . . shall be void or voidable **solely** for this reason" *See* 8 Del. Code § 144. Here, however, the Plaintiff has already properly pleaded that this was a conflicted transaction which requires either intermediate or enhanced scrutiny to determine. *See* Part III(A)(2), *supra*. The motion to dismiss this cause of action is, therefore, denied.

2. Whether the Court Should Issue a Declaration Regarding the Sale of the 111 W. 57th Street Property Rights

Plaintiff seeks a declaration as to the respective rights and interests in Ambase's shareholders as it relates to any sale of the 111 W. 57th Street. The Defendant argues that

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such a declaration is entirely improper given that the relief sought would only become effective upon the occurrence of a future event. *See Sutton Madison, Inc. v. 27 E. 65th St. Owners Corp.*, 68 A.D.3d 512, 513 (1st Dep't 2009) *citing Gates v. Hernandez*, 26 A.D.3d 288, 289 (1st Dep't 2006). Indeed, as noted by the appellate division:

While the issues raised by petitioner may be considered substantial and novel and likely to recur, this matter nevertheless falls outside the exception to mootness doctrine, because these issues are not the type that typically evade judicial review. Indeed, these issues are typically susceptible to review, and thus can and should be resolved if and when they arise in the context of a viable justiciable controversy. *See Gates v. Hernandez*, 26 A.D.3d at 289.

Therefore, the Court dismisses the fifth cause of action.

III. DECISION AND ORDER

As a result of the foregoing, it is hereby

ORDERED that Defendants Alessandra F. Bianco Halloran, Richard A. Bianco Jr., Jerry Y. Carnegie, John Ferrara, and Joseph R. Bianco are dismissed; further

ORDERED, the motion to dismiss is granted in part and denied in part as to Defendants Richard A. Bianco and Kenneth M. Schmidt. The first and fifth causes of action are dismissed in their entirety and the third cause of action is dismissed in part. The remaining causes of action may remain as against Defendants Bianco and Schmidt; further

ORDERED the action is severed and continued against Defendants Bianco and Schmidt; further

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ORDERED Defendants Bianco and Schmidt shall have 20 days to file an answer; and it is further

ORDERED the parties shall contact the Part 3 Clerk to schedule a status conference.

Dated: December 26, 2018

ENTER:



HON. EILEEN BRANSTEN
J.S.C.