Philips South Beach, LLC v Morgans Hotel Group Management, LLC
2006 NY Slip Op 30047(U)
July 26, 2006
Supreme Court, New York County
Docket Number: 0600147/0147
Judge: Richard B. Lowe

[*1]

SCANNED ON 8/1/2006

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

RICHARD B. LOWE III

PART 56

Index Number : 600147/2006

PHILIPS SOUTH BEACH LLC

VS

MORGANS HOTEL GROUP MANAGEMEN

Sequence Number : 001

DISMISS ACTION

INDEX NO. _____

MOTION DATE _____

MOTION SEQ. NO. _____

MOTION CAL. NO. _____

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

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

Cross-Motion: ☐ Yes ☑ No

Upon the foregoing papers, it is ordered that this motion

4

MOTION IS DECIDED IN ACCORDANCE WITH ACCOMPANYING MEMORANDUM DECISION

FILED
AUG 01 2006
COUNTY CLERK'S OFFICE
NEW YORK

Dated: July 26, 2006

RICHARD B. LOWE III J.S.C.

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

Check one: ☐ FINAL DISPOSITION ☑ NON-FINAL DISPOSITION

Check if appropriate: ☐ DO NOT POST ☐ REFERENCE

SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK: IAS PART 56

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PHILIPS SOUTH BEACH, LLC,

Plaintiff,

-against-

Index No. 600147/2006

MORGANS HOTEL GROUP MANAGEMENT, LLC f/k/a IAN SCHRAGER HOTEL MANAGEMENT, LLC, MORGANS HOTEL GROUP, LLC f/k/a IAN SCHRAGER HOTELS, LLC, BEACH HOTEL ASSOCIATES, LLC, IAN SCHRAGER, W.EDWARD SCHEETZ, DAVID T. HAMAMOTO, and JOHN DOE 1 through 10,

DECISION AND ORDER

Defendants.

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RICHARD B. LOWE, III, J.:

Pursuant to CPLR 3211 (a) (1) and (a) (7), Defendants, Morgans Hotel Group Management, LLC f/k/a Ian Schrager Hotel Management, LLC, Morgans Hotel Group, LLC f/k/a Ian Schrager Hotels, LLC, Beach Hotels Associates, LLC, Ian Schrager, W. Edward Scheetz, David T. Hamamoto, and John Doe 1 through 10 (collectively "Morgans") move to dismiss plaintiff's complaint against all defendants with prejudice.

BACKGROUND

This contract dispute arises out of the party's understanding of Morgans' responsibilities and benefits set forth in the hotel's management agreement.

In or around 2002, Morgans Hotel Group corporate officers, Ian Schrager, CEO;[1] W.

[1]At all relevant times, Ian Schrager was the CEO of Morgans Hotel Group Management, LLC. In July 2005, W. Edward Scheetz succeeded Schrager as CEO. (Bagli, *New York Times*, July 12, 2005.)

Edward Scheetz, President; and David Hamamoto, Chairman of the Board (hereinafter collectively "corporate officers"), negotiated with Philips South Beach (Philips) to manage and operate the Shore Club Hotel. During negotiations, Philips raised concerns because Hamamoto, Scheetz, and other Morgans' affiliates were shareholders in the company that owned the Shore Club's largest direct competitor, the Delano Hotel. The Delano, also managed by Morgans, was the model for the Shore Club's management plan. Morgans assured Philips that both relationships would not conflict because they were mutually exclusive. Also, Morgans affirmed that Philips would be able to monitor all Morgans' activities and Morgans would equitably allocate the management expenses between the two properties. As a result, on or about July 1, 2002, Philips entered a twenty-year management agreement with Morgans to act as Operator and Managing Agent for the Shore Club Hotel.

By 2005, Philips suspected that there were discrepancies in Morgans' management reports and Morgans' method of operating the Shore Club was inconsistent with the terms of the management agreement. Philips alleges that within three years, Morgans had provided over 500 nights of complimentary rooms, food, beverages, and services to employees of the Delano Hotel and Ian Schrager. Morgans' management reports listed these complimentary rooms as "out of order" and did not include documentation of the gratuitous meals and services. Philips alleges the false reports were an intentional ploy by Morgans to hide any financial inconsistencies from Philips. Philips additionally affirms that while Morgans and Delano employees were gratuitously occupying the better rooms, those rooms gained no revenue and were not available for discerning, celebrity guests. Philips claims Morgans subsequently diverted those guests to the Delano by falsely informing reserved guests that Shore Club rooms were unavailable and they

were being "upgraded" to the Delano.

According to Philips, financial discrepancies were not limited to rooms and services. Philips claims Morgans entered barter advertising agreements intended to promote the Shore Club but the Delano received the advertising benefits and the Shore Club absorbed the advertising expenses. For example, JetBlue Airlines exchanged free airline tickets and advertising of the Shore Club for complimentary rooms at the hotel. Philips claimed that Morgans distributed the airlines tickets to only Morgans' employees and featured the Delano Hotel in the advertisements; omitting any reference to the Shore Club. Meanwhile, the Shore Club provided the complimentary rooms and services to all JetBlue employees. Philips argues that biased representation and expense misallocation were major concerns prior to contracting with Morgans and Morgans' deliberate abuse of their discretion directly violates the agreement.

In addition, Philips claims Morgans failed to collect rents and taxes from the Shore Club's commercial tenants. Commercial tenants were obligated to pay rent based on a percentage of their sales and provide periodic financial statements to Morgans. Philips claims the Shore Club's controller reported that Morgans decided not to allocate resources necessary to monitor and collect rents.

Philips alleges causes of action for: a declaratory judgment terminating the management agreement (first cause of action); breach of fiduciary duty (second and third causes of action); aiding and abetting breach of fiduciary duty (fourth cause of action); breach of contract (fifth cause of action); breach of implied good faith and fair dealing (sixth cause of action); tortious interference with business relations (seventh cause of action); unfair competition (eighth cause of

action); and unjust enrichment (ninth cause of action).[2]

Morgans moves to dismiss the complaint in its entirety, pursuant to CPLR 3211(a) (1) and (a) (7), by offering the original agreement as documentary evidence. Morgans maintains that the agreement expressly repudiates the existence of a fiduciary relationship and that they engaged in no conduct outside the scope of "full control and discretion in the operation, direction, management, and supervision of" the Shore Club expressed in the agreement.

Morgans also argues that Philips pleads no evidence to substantiate breach of implied good faith and fair dealing, tortious interference with business relations, unfair competition, and unjust enrichment. Morgans maintains that the collective evidence supports a dismissal of the declaratory judgment and enforcement of the existing contract. The court addresses each cause of action in turn.

DISCUSSION

I. STANDARD OF REVIEW

When deciding a motion to dismiss under CPLR 3211 (a) (1) and (a) (7), the threshold issues for the court are, respectively, whether the allegations in the pleading present a cognizable cause of action and whether documentary evidence conclusively negates or resolves the factual allegations. (*See Biondi v Beekman Hill House Apt. Corp.*, 257 AD2d 76, 80 [1st Dept 1999] *aff'd* 94 NY2d 659 [2000] citing *Guggenheimer v Ginzburg*, 43 NY2d 268,275 [1977]; *Silvester v Time Warner*, 1 Misc 3d 250, 255 [Sup Ct, NY County 2003]).

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[2]Morgans withdrew their motion to dismiss alleging lack of jurisdiction because Philips has filed a certificate of authority with the Secretary of State in New York and is qualified to do business in New York.

A motion to dismiss pursuant to CPLR 3211 (a) (1) requires the court to liberally construe the pleadings in favor of the plaintiff and regard them as true. The court must consider whether plaintiff *has* a cognizable cause of action, "not whether he has stated one, and, unless it has been shown that ... a[n alleged] fact ... is not a fact at all and ... no significant dispute exists regarding [that fact], ... dismissal should not eventuate." (*Guggenheimer,* 43 NY2d at 275). However, under CPLR 3211(a) (7), if documentary evidence flatly contradicts the plaintiff's allegations, the allegations are not entitled to consideration. (*Herman v Greenberg*, 221 AD2d 251 [1st Dept 1995]).

II. PHILIPS' CAUSES OF ACTION

A. Breach of Fiduciary Duty

According to Philips, Morgans impliedly was obligated as a fiduciary because Philips relied on Morgans' expertise as an "agent" acting on their behalf and the parties' relationship achieved a higher level of trust than an ordinary business transaction. Philips maintains that Morgans identified and availed themselves as an agent in § 22.5 of the management agreement.

Morgans argues that § 22.5 clearly repudiates any fiduciary obligation. Morgans points to the plain meaning of the clause to show that there was never an intention, creation, or existence of a fiduciary obligation between the parties. The agreement provision reads as follows:

> 22.5 The Operator as Agent. The Operator will perform all of its duties hereunder as agent for the Owner, and nothing herein contained shall constitute or be construed to be or create a co-partnership, joint venture, trustee, fiduciary [sic] or landlord/tenant relationship between the Owner and the Operator with respect to the management of the Hotel as provided for in this Agreement.

(Shah Aff., Ex. 3 at 42).

Generally, absent extraordinary circumstances, a commercial business relationship does not create "a relationship of confidence and trust sufficient to find the existence of fiduciary duty." (*Wilhelmina Artist Management, LLC v Knowles*, 8 Misc 3d 1012[A] 2005 [Sup Ct, NY County, 2005], citing *Surge Licensing, Inc. v Copyright Promotions Ltd.*, 258 AD2d 257 [1st Dept 1999]). Alternatively, Philips argues that courts have found fiduciary relationships where none previously existed by scrutinizing the actual relationships of the parties. However, courts usually scrutinize the intent and scope of the business relationship *in the absence of an express provision* that qualifies the relationship. (*See Sergeants Benevolent Ass'n Annuity Fund v Renck*, 19 AD3d 107, 111 [1st Dept 2005]; *CBS Corp. v Dumsday*, 268 AD2d 350 [1st Dept 2000]). When the contract has an express provision, the question turns on whether the terms are "clear and unmistakable" capable of "no other reasonable interpretation." (*Wright v Evanston Ins. Co.*, 14 AD3d 505, 505-6 [2d Dept 2005]).

Here, an ordinary reading of § 22.5 communicates that "*nothing*" in the agreement "*shall constitute or be construed to be or create a ... fiduciary... relationship between the Owner and the Operator.*" This language is clear, direct, and not subject to varied interpretation.

Philips argues that the critical portion of § 22.5 confirms "[t]he Operator as Agent" and that "[t]he Operator will perform all of it duties ... as agent for the owner" (emphasis in original). Philips contends they understood § 22.5 to mean that Morgans excluded every other fiduciary relationship except that of "agent." Notwithstanding Philips' interpretation, mere identification of a party as an "agent" in a contract does not invoke a fiduciary duty. The court in *Surge Licensing* held that no fiduciary relationship existed where the parties had an arms length, conventional licensing agreement, even though the contract identified parties as "principal" and

"agent." (258 AD2d at 257). More important, courts will not, "under the guise of interpretation," rewrite or alter a contract "if to do so would contradict the clearly expressed language of the contract." (*Evans v Famous Music Corp.*, 302 AD2d 216, 217 [1st Dept 2003]).

Philips and Morgans, having equal bargaining power, freely executed this management agreement. Both are sophisticated parties with a vast knowledge and understanding of hotel operations. During negotiations, Philips investigated Morgans extensively enough to discover Morgans' affiliations with an independent company that owned the Delano Hotel. Philips expeditiously raised concerns regarding Morgans' affiliations and possible conflicts with other agreement terms. Philips actions prior to signing the agreement indicate they reviewed the document to eliminate conflicting interests and § 22.5 was not addressed.

There is no question that § 22.5 rejects the existence of a fiduciary relationship between the parties. In that, Philips cannot introduce extrinsic evidence that contradicts the provision's definitive language. Accordingly, defendant's motion to dismiss the cause of action for breach of fiduciary duty is granted.

B. Aiding and Abetting Breach of Fiduciary Duty

Philips alleges that Morgans' corporate officers aided and abetted Morgans' breach of their fiduciary duties. A cause of action for aiding and abetting a breach of fiduciary duty requires that Philips factually show Morgans breached a fiduciary duty owed to Philips, the corporate officers knowingly participated in that breach, and Philips incurred damages as a result. (*See S & K Sales Co. v Nike, Inc.*, 816 F2d 843 [2d Cir 1987]). Philips argument fails on two counts.

First, because aiding and abetting breach of fiduciary duty is a derivative action of breach

of fiduciary duty, the dismissal of the latter cause of action invalidates the former. (*See Kaufman v Cohen*, 307 AD2d 113, 124 [1st Dept 2003]). Second, the details Philips plead in support of the officers knowing participation in Morgans' alleged deception is conclusory. New York law requires actual knowledge and constructive knowledge is not enough. (*See id.* at 125; *Sterling National Bank v Ernst & Young*, 9 Misc 3d 1129[A] [Sup Ct, NY County 2005]). Philips merely states the officers "were aware of Morgan's breach," that "concerns were expressed" to Schrager, and that these corporate officers received comprehensive reports detailing Morgan's misconduct. Philips provides no documentation to substantiate these allegations factually. Statements regarding the officer's constructive knowledge of Morgans' misdeeds are insufficient to conclude they knowingly participated in the conduct. Therefore, the motion to dismiss this cause of action is granted.

C. Breach of Contract

Generally, courts determine whether contractual language is unambiguous on its face as a matter of law. (*See Metropolitan Life Ins. Co v RJR Nabisco Inc.*, 906 F2d 884 [2d Cir 1990]). "Contractual language is unambiguous if it has a definite and precise meaning, unattended by danger of misconception in the purport of the contract itself, and concerning which there is no reasonable basis for a difference of opinion." (*Karas v Katten Muchin Zavis Rosenman*, 2006 WL 20507, *5 [SD NY Jan 3, 2006]). Thus, if an agreement on its face is reasonably susceptible to more than one meaning, the meaning of those terms cannot be resolved on a motion to dismiss. (*See Amusement Bus. Underwriters v Amer. Int'l Grp, Inc.*, 66 NY2d 878, 880 [1985]; *see also Funomenon! LLC v Canner*, Sup Ct, NY County, August 30, 2000, Cozier, J., Index No. 605606/99).

In *Karas*, the court denied defendant's summary judgment motion that attacked a provision in the law firm's merger contract. The contract stated that plaintiff, who sold his law practice to a larger firm, would remain employed for three years following the merger and "devote his time to the practice ... [which] ... would be reduced commensurate to his reduction in salary." (2006 WL 20507 at *8.) The parties' interpretation differed on whether plaintiff's reduction of time devoted to the "practice" meant he was obligated to devote *any* time to the practice of *law*.

Similarly, Philips substantiates their allegations with the same agreement provisions Morgans produces to negate those allegations. For example, Philips alleges Morgans did not operate the Shore Club with "reasonable discretion," "with integrity," or "in the best interest of the Owner" as required by the agreement (*see* Shaw Aff, Ex. 3). Philips asserts that Morgans provided over 500 nights of complimentary rooms and services for the Delano's chef and general manager. Philips considered this fraudulent and abusive use of discretion because the Delano employees "provided no services to the Shore Club" (*see* Complaint).

Morgans points to the same provision to affirm that it is irrelevant the employees provided no services to the Shore Club because Morgans can provide complimentary guest rooms to "*any employee of the Owner or the Operator*" (*see* Shaw Aff, Ex. 3 [emphasis added]). Morgans further states that because the agreement gave them broad authority to operate the hotel "exclusive[ly] and undisturbed [by Philips]," their actions were with the scope of the agreement. Morgans contends that substantial increases in the Shore Club's revenues and market share is a direct result of Morgans using reasonable discretion in the best interest of Philips.

The provisions that articulate Morgans' responsibilities are, in pertinent part:

WHEREAS, the Owner desires to obtain *the benefits of the Operator's expertise* in the management and operation of the Hotel *by granting the Operator complete and full control and discretion in the operation, direction, management [sic] and supervision of the Hotel*, subject to the limitations in this agreement, and the Operator desires to assume such control and discretion upon the terms and conditions set forth in this Agreement; ...

4.2 The Operator's Control and Discretion. ...[Morgans is permitted to:]

(d) Subject ... to the applicable requirements of the Existing Loan Documents...negotiate and enter into leases, subleases, licenses [sic] and concession agreements for stores, restaurants...commercial space...

(h) Determine all terms for admittance and charges to be made for guest and function rooms, commercial space privileges, and, subject to any applicable terms of Existing Leases, entertainment and food and beverages...

(j) Establish entertainment and amusement policies (including pricing) with respect to the Hotel...

(k)...establish food and beverage policies (including pricing) with respect to the Hotel...

(m) Establish and implement all advertising, public relations [sic] and promotional policies... exercising the *sole and exclusive control* over all *paid* advertising, press releases [sic] and conferences...

(o) Enter into brokerage agreements with respect to leasing of space at the Hotel.

(p) ...establish any other policy or *perform any other act or function* which if the *reasonable discretion of the Operator* is necessary to operate the hotel on a day-to-ay basis in accordance with Hotel standards...

4.6 Complimentary Services.

(a) The Operator *may provide such guest rooms or other facilities, and any food or beverages, on a complimentary or discount basis to any employee of the Owner or the Operator or other guests as the Operator may reasonably determine to be advisable.* However, such complimentary or discount room, food [sic] and beverage *shall be made available for the best interests of the Owner* and *with integrity*.

(b) The Operator, in its reasonable discretion, may provide food for Hotel employees, and *allow the general manager of the Hotel and the general manager's family suitable living quarters* within or outside the Hotel and the use of all facilities of the Hotel.

(c) The Operator shall permit the members, and the members in the

> members (including in each case, the principles thereof), of the Owner and their immediate family members to stay at the Hotel from time to time on a complimentary basis, provided that *such privilege shall not be abused.*

(*See* Shah Aff., Ex. 3 at 13-18 [emphasis added]).

The agreement expressly permits Morgans to use their "control and discretion" to "perform any act or function which ... is necessary to operate the Hotel."

Construing every possible inference in favor of the plaintiff, there is a question of fact whether Morgans' actions were "reasonable," "proper," and within the scope of the agreement. Therefore, the motion to dismiss the breach of contract cause of action is denied.

D. Breach of Implied Good Faith and Fair Dealing

The Court of Appeals has stated that where a claim for breach of the implied covenant of good faith and fair dealing is "duplicative of the ...cause of action for breach of contract," the claim should be dismissed. (*Funomenon!*, Index No. 605606/99, citing *New York Univ. v Continental Ins. Co.*, 87 NY2d 308, 320 [1995]). Philips asserts the same allegations here as in the breach of contract action creating a duplicative action. Therefore, this cause of action should be dismissed.

E. Tortious Interference with Business and Economic Relations

Philips must plead that Morgans interfered with a business relationship that Philips had with a third party, that Morgans interference was for a wrongful purpose or by dishonest, unfair, or improper means, and Morgans' actions injured that business relationship. (*See Nadel v Play-by-Playtoys & Novelties,* 34 F Supp 2d 180 [SD NY 1999]).

Philips asserts that Morgans' actions encumbered their business relationships with Shore

Club's guests. For example, front desk staff transferred a discerning, repeat client to the Delano because rooms were not available at the Shore Club. Philips asserts that the guests were extremely upset with how the Shore Club treated them.

Morgans contends that § 4.2 (h) of the management agreement permits Morgans to "determine all terms of admittance ... to be made for guest ... rooms...," and transferring guests to a comparable hotel does not impede the Shore Club's relationship with those guests.

As previously concluded, the agreement broadly and ambiguously constructs the terms relating to Morgans actual responsibilities. Defendant's motion to dismiss is denied because Morgans must establish the integrity of their actions to overcome tortious interference.

F. Unfair Competition

A cause of action for unfair competition is "generally predicated upon the alleged bad faith misappropriation of a commercial advantage belonging to another by exploitation of proprietary information or trade secrets." (*Volt Delta Resources LLC v Soleo Comm. Inc.*, 11 Misc 3d 1071[A], *6-7 [Sup Ct, NY County 2006]).

Philips alleges the names and addresses of the Shore Club's clients is confidential information. Philips contends this information is not readily available to those within the hotel industry and Morgans utilized that information to increase revenue at the Delano. Therefore, Morgans exploited that information for their commercial advantage.

Whereas Philips has plead the necessary elements for unfair competition, Morgans provides no factual evidence that conclusively disproves Philips allegations. Consequently, the cause of action for unfair competition can stand.

G. Unjust Enrichment

Philips asserts that Morgans diverted business from the Shore Club to the Delano and improperly allocated a substantial portion of shared expenses to the Shore Club. Philips contends that revenues Morgans received because of these actions unjustly enriched Morgans.

Morgans contends that the unjust enrichment claim is defective because the parties had a valid contract, Philips does not seek restitution as a remedy, and Philips performed no beneficial services for Morgans.

A claim of unjust enrichment is fatal where a valid and enforceable contract regarding the same subject matter exists. (*See Sergeants Benev. Assn. Annuity Fund*, 19 AD3d at 107). In the present case, Philips did not aver that the contract was not viable. Therefore, Philips cannot recover for unjust enrichment while "simultaneously alleging the existence of an express contract covering the same subject matter." (*id.* at 119, quoting *MJM Adv. v Panasonic Indus. Co.*, 294 AD2d 265, 266 [1st Dept 2002]). The motion to dismiss this cause of action is granted.

H. Punitive Damages

Philips seeks punitive damages as a remedy for breach of fiduciary duty and aiding and abetting breach of fiduciary duty. Morgans argues punitive damages are not recoverable in this case because the damages remedy a private matter.

Generally, punitive damages are not recoverable in breach of contract claims and are reserved to vindicate public rights. (*Volt*, 11 Misc3d 1071[A], quoting *Rocanova v Equitable Life Assur. Socy. of U.S.*, 83 NY2d 603, 613 [1994]). However, in tort claims punitive damages are not only recoverable, it is a "question[] which reside[s] in the sound discretion of the original trier of fact.... That the harm alleged might not have been aimed at the general public does not

alter this result." (*Swersky v Dreyer & Traub*, 219 AD2d 321 [1st Dept 1996]).

Philips is entitled to seek punitive damages in relation to tort actions; however, the actions on which they seek punitive damages have been dismissed. Therefore, punitive damages may not be awarded.

CONCLUSION

Accordingly, it is hereby

ORDERED that the defendants' motions to dismiss is granted to the extent dismissing the second, third, fourth, sixth, and ninth causes of action and is otherwise denied; it is further

ORDERED that the remainder of the action is severed and continued; and it is further

ORDERED that the defendants are directed to serve an answer to the complaint within 10 days after service of a copy of this order with notice of entry.

THE FOREGOING CONSTITUTES THE ORDER AND DECISION OF THIS COURT.

Dated: July 26, 2006

ENTER:

RICHARD B. LOWE III

RICHARD B. LOWE, III, J.S.C.

FILED
AUG 01 2006
COUNTY CLERK'S OFFICE
NEW YORK