

**Century Operating Assocs. v Northstar
Hospitality LLC**

2007 NY Slip Op 30748(U)

April 5, 2007

Supreme Court, New York County

Docket Number: 0601007/2006

Judge: Karla Moskowitz

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

PRESENT: Hon. KARLA MOSKOWITZ
FBEM Justice

PART 03

-----X
CENTURY OPERATING ASSOCIATES, a New York Limited Partnership,

Plaintiff,

-against-

NORTHSTAR HOSPITALITY LLC, a Delaware Limited Liability Company;
NORTHSTAR CAPITAL INVESTMENT CORP., a Delaware Corporation;
NORTHSTAR PARTNERSHIP, LP, a Delaware Limited Partnership; MHG
ASSOCIATES, LP, a Delaware Limited Partnership; MORGANS HOTEL
GROUP, LLC, as successor in interest to IAN SCHRAGER HOTELS, LLC;
IAN SCHRAGER, individually; EDWARD SCHEETZ, individually; DAVID
HAMAMOTO, individually; RSA ASSOCIATES, L.P., a Delaware Limited
Partnership; and MORGANS HOTEL GROUP, CO., a Delaware Corporation;
and MORGANS GROUP LLC, a Delaware Limited Liability Company,

Defendants.
-----X

INDEX NO. 601007/2006E

MOTION DATE _____

MOTION SEQ. NO. 002

MOTION CAL. NO. _____

numbered 1 to _____ were read on this motion to/for _____

The following papers,

Notice of Motion/ Order to Show Cause — Affidavits — Exhibits _____

Answering Affidavits — Exhibits _____

Replying Affidavits _____

PAPERS NUMBERED
FILED
APR 12 2007
NEW YORK
COUNTY CLERK'S OFFICE

Cross-Motion: Yes No

Upon the foregoing papers, it is

ORDERED that this motion is decided in accordance with the accompanying
Decision and Order.

Dated: April 5, 2007

KARLA MOSKOWITZ J.S.C.

Check one: FINAL DISPOSITION NON-FINAL DISPOSITION

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

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CENTURY OPERATING ASSOCIATES, a New York
Limited Partnership,

Plaintiff,

Index No. 601007/2006

-against-

NORTHSTAR HOSPITALITY LLC, a Delaware Limited Liability Company; NORTHSTAR CAPITAL INVESTMENT CORP., a Delaware Corporation; NORTHSTAR PARTNERSHIP, LP, a Delaware Limited Partnership; MHG ASSOCIATES, LP, a Delaware Limited Partnership; MORGANS HOTEL GROUP, LLC, as successor in interest to IAN SCHRAGER HOTELS, LLC; IAN SCHRAGER, individually; EDWARD SCHEETZ, individually; DAVID HAMAMOTO, individually; RSA ASSOCIATES, L.P., a Delaware Limited Partnership; and MORGANS HOTEL GROUP, CO., a Delaware Corporation; and MORGANS GROUP LLC, a Delaware Limited Liability Company,

DECISION and ORDER

FILED
APR 12 2007
NEW YORK
COUNTY CLERK'S OFFICE

Defendants.

-----X
Moskowitz, J.:

In this action, plaintiff Century Operating Associates ("Century") seeks damages from defendants' transfer of assets that allegedly deprived Century of proceeds in connection with the initial public offering of defendant Morgans Hotel Group, Co. ("Morgans Co."). The five-count amended complaint asserts causes of action for breach of contract, breach of fiduciary duty, aiding and abetting breach of fiduciary duty and fraudulent conveyance.

Only the following defendants are movants on this motion (sequence number 002):
Morgans Co., Morgans Group, NorthStar Hospitality LLC ("NorthStar"), MHG Associates, LP ("MHG"), Ian Schrager ("Schrager"), Edward Scheetz ("Scheetz") and David Hamamoto ("Hamamoto"). These defendants move to dismiss the second and third causes of action in their entirety and the fourth and fifth causes of action as against Morgans Co. and defendant Morgans

Group LLC (“Morgans Group”) for failure to state a cause of action and based upon documentary evidence. The remaining defendants submit no papers for this motion.

Facts

NorthStar, MHG and Century were members of defendant Ian Schrager Hotels, LLC (“Schrager Hotels”) pursuant to an Amended and Restated Limited Liability Company Agreement of Ian Schrager Hotels LLC dated February 13, 1998 (“Agreement”). According to the Agreement, New York law governed. NorthStar contributed \$102 million to Schrager Hotels and MHG contributed \$20 million. Century contributed \$1 and allegedly contributed certain hotel interests.

Section 7.1 of the Agreement defined the events triggering distributions to Century as “Net Capital Proceeds” (as derived from a “Capital Event”) and “Ordinary Cash Flow,” and stated the method for calculating distributions. The Agreement’s distribution formulae provided for pro rata payments to Members, entitling NorthStar to receive a priority return of “Unreturned Capital Contributions” plus interest. The Agreement then provided for a percentage payment to MHG before Century could receive a distribution. Century claims that, since February 1998, NorthStar and MHG have received distributions but not Century.

In mid-2004, Schrager Hotels allegedly entered into a transaction with defendant Morgans Hotel Group, LLC (“Morgans”), in which Morgans assumed the assets and liabilities of Schrager Hotels. On May 20, 2004, Morgans converted from a New York to a Delaware limited liability company. Morgans, Morgans Co., NorthStar and defendant RSA Associates, L.P. (“RSA”) amended the Agreement by executing an Amended and Restated Limited Liability Company Agreement of Morgans Group dated June 24, 2005 (“Amended Agreement”). The

Amended Agreement changed the governing law from New York to Delaware.

On October 25, 2005, Morgans Group, Morgans, NorthStar Hospitality LLC, defendant NorthStar Partnership, LP (together with NorthStar Hospitality LLC “NorthStar”), RSA and non-parties Michael Overington and Anda Andrei entered into a Formation and Structuring Agreement (“F&S Agreement”). Century claims that, under the F&S Agreement, Morgans transferred its assets to Morgans Group, its wholly owned subsidiary, for no consideration. This transfer allegedly included 100% of Morgans’ membership interest in non-party Morgans Hotel Group Management LLC (“Morgans Management”), an entity that managed Morgans’ hotels. The F&S Agreement also allegedly provided for Morgans’ distribution of membership interests in Morgans Group to the parties to the F&S Agreement, to the exclusion of Century. In addition, the parties to the F&S Agreement allegedly could exchange their interests in Morgans Group for shares of common stock in Morgans Co., also to the exclusion of Century. These transactions allegedly closed simultaneously with the IPO of Morgans Co. While Morgans Co. was not a signatory to the F&S Agreement, Century claims that Morgans Co. consented to the terms of these exchange transactions. In essence, Century claims entitlement to membership interests in Morgans Group and seeks to exchange those interests for Morgans Co. common stock.

Century avers that Morgans Co.’s prospectus (“Prospectus”), filed with the United States Securities and Exchange Commission, states that Morgans Co. is not obligated to consider the separate interests of its non-managing members when making decisions on behalf of Morgans Group. The net effect of the F&S Agreement is to give Morgans Co. a 97.1% ownership interest in, and control over, Morgans Group, that will own substantially all of the assets Morgans (and, indirectly, Century, as a member of Morgans) previously owned.

The IPO of Morgans Co. allegedly took place on February 14, 2006 and generated net proceeds of approximately \$273 million. Century claims that this constitutes a Capital Event under the Agreement, entitling it to distributions. Century claims that two assets Morgans retained (and did not transfer to Morgans Group) were \$35.7 million in cash and membership interests in Morgans Management. Morgans members allegedly received the cash, to the exclusion of Century. The IPO also permitted the exchange of membership interests in Morgans Management for membership interests in Morgans Group that were exchangeable for Morgans Co. common stock, again to the exclusion of Century.

According to Century, Morgans Co.'s Prospectus states that NorthStar and "Morgans Hotel Group Investors (including RSA Associates L.P.)" contributed 100% of Morgans to Morgans Co. but does not mention Century as a contributor, thereby claiming Century's interest as their own. Century asserts that, as a result of these transactions, Morgans allegedly could not satisfy its obligations to Century.

Discussion

Breach of Fiduciary Duty

Movants seek dismissal of the second cause of action for breach of fiduciary duty and argue that Century fails to allege bad faith under the Agreement. Plaintiff asserts this cause of action against NorthStar, MHG, Schragger, Scheetz and Hamamoto.

Section 5.4 of the Agreement provides that "in no event shall [Century's] interest in [Schragger Hotels] as a Member hereunder carry with it any right to vote on or approve any decision. ... Additionally, the Board of Managers, by Supermajority Decision, may amend or modify this Agreement ... without the consent of or notice to [Century]" The Amended

Agreement contains the same language.

Section 13.12 of the Agreement states that New York law governs. Morgans converted from a New York to a Delaware limited liability company on May 20, 2004, and the Amended Agreement modifies section 13.12 to state that Delaware law now governs the parties' agreement. The conversion and the amendment to the Agreement occurred before the facts giving rise to Century's claims. Therefore, Delaware law governs. In any event, both agreements contain the same relevant contract language and, as a result, with respect to applying that contract language, whether New York or Delaware law governs is irrelevant.

Under Delaware law, where the member or manager of a limited liability company has fiduciary duties to the company or another member of the company, those "duties may be expanded or restricted or eliminated by provisions in the limited liability company agreement." (6 Del C §§ 18-1101 [c]-[e]). Unless that agreement states otherwise, Delaware law limits liability for the member's or manager's "good faith reliance on the provisions of the limited liability company agreement." (*Id.*).

Section 10.2 of both the Agreement and the Amended Agreement, concerning exculpation and fiduciary duties, provides that no "Covered Person" (defined to include the named defendants in this cause of action) shall be liable for acts or omissions the "covered person" performed in good faith. Section 10.2 (b) includes reliance upon:

records of the Company and upon such information, opinions, reports or statements presented to the Company ... including formation, opinions, reports or statements as to the value and amount of the assets, liabilities, Profits, Losses, proceeds from Capital Events or Cash Available For Distribution or any other facts pertinent to the existence and amount of assets from which distributions to Members might properly be paid.

Section 10.3 (a), entitled “Fiduciary Duty,” states that “a Covered Person acting under this Agreement shall not be liable to the Company or to any other Covered Person for its good faith reliance on the provisions of this Agreement.” Section 10.3 (b) pertains to resolution of conflicts of interest between Covered Persons and issues arising from a Covered Person’s obligation to “act in a manner that is ... fair and reasonable to the Company or any Member” Under section 10.3 (b), “[i]n the absence of bad faith by the Covered Person, the resolution, action or term so made, taken or provided by the Covered Person shall not constitute a breach of this Agreement or any other agreement contemplated herein or of any duty or obligation of the Covered Person at law or in equity or otherwise.” Sections 10.2 and 10.3 of the Agreement are virtually identical to these sections in the Amended Agreement.

The amended complaint does not allege that defendants performed any act in bad faith or that defendants failed to use good faith. Thus, pursuant to the Agreement or the Amended Agreement, Century has not alleged a claim for breach of fiduciary duty against NorthStar, MHG, Schrage, Scheetz or Hamamoto. Accordingly, the court grants the motion to dismiss the second cause of action for breach of fiduciary duty.

Aiding and Abetting Breach of Fiduciary Duty

Movants seek dismissal of the third cause of action for aiding and abetting breach of fiduciary duty, that plaintiff asserts solely against Morgans Co. Movants argue that there is no aiding and abetting a breach of fiduciary duty when no party has breached a fiduciary duty.

If there is no breach of fiduciary duty, a claim for aiding and abetting a breach of that fiduciary duty fails. (*Steinman v Levine*, 2002 WL 31761252, *14 [Del Ch 2002], *affd* 822 A2d 397 [Del 2003]; *Fiala v Metropolitan Life Ins. Co.*, 6 AD3d 320, 323 [1st Dept 2004] [when a

court dismisses a claim for breach of fiduciary duty, a “claim ... for aiding and abetting a breach of fiduciary duty cannot stand”]). Because the court dismisses the second cause of action for breach of fiduciary duty, the court also dismisses the third cause of action for aiding and abetting a breach of fiduciary duty.

Fraudulent Conveyance

Plaintiff asserts the fourth and fifth causes of action for fraudulent conveyance against all defendants. Movants seek dismissal of these claims only as against Morgans Co. and Morgans Group. Plaintiff bases the fourth cause of action on section 274 of New York’s Debtor and Creditor Law and the fifth cause of action on sections 276 and 276-a..

Under section 274,

[e]very conveyance made without fair consideration when the person making it is engaged or is about to engage in a business or transaction for which the property remaining in his hands after the conveyance is an unreasonably small capital, is fraudulent as to creditors and as to other persons who become creditors during the continuance of such business or transaction without regard to his actual intent.

Under section 276, “[e]very conveyance made and every obligation incurred with actual intent, as distinguished from intent presumed in law, to hinder, delay, or defraud either present or future creditors, is fraudulent as to both present and future creditors.” Section 276-a entitles the party that the fraudulent conveyance has injured to seek attorneys’ fees.

Century bases both the fourth and fifth causes of action on the allegation that Morgans transferred its assets to Morgans Group without consideration. This allegation, however, is inconsistent with Century’s claim of a right to a distribution because the IPO is a “Capital Event” under the Agreement. Both the Agreement and the amended complaint define Capital Event as

“any event not occurring in the ordinary course of business, pursuant to which the Company [Schrager Hotels, Morgans’ predecessor] or its Subsidiary (as the case may be) receive[s] any consideration with respect to its assets or the disposition thereof” (Levin Aff., Ex. A, at 5). In other words, Century’s alleged entitlement to a distribution under the Agreement in connection with the IPO implicitly relies on its concession that Morgans received consideration. This concession undermines both fraudulent conveyance claims with respect to Morgans Co. and Morgans Group. Century expressly acknowledges this in its opposition papers by arguing that a fraudulent conveyance occurred because Morgans “distributed membership units in Morgans Group ... to the exclusion of Plaintiff, even though Plaintiff was entitled to such distribution under the Operating Agreement.” (Century Opp. Mem. of Law, at 8).

The Agreement entitled Century to distributions after NorthStar and MHG received payments. Assuming that Century did not receive a distribution in connection with the transactions at issue here, the distribution formulae of the parties’ agreements should have resolved this matter. Indeed, breach of contract is Century’s first cause of action, and movants do not challenge it in this motion. Moreover, the amended complaint relies on the Prospectus to support Century’s argument that Morgans received no consideration for its transfer of assets to Morgans Group, leaving Morgans as an “asset-barren shell.” (Century Opp. Mem. of Law, at 1). However, the Prospectus also states that, after the IPO, Morgans would own 1 million (or 2.9%) of the membership units in Morgans Group, exchangeable on a one-to-one basis for Morgans Co. stock. (Prospectus, at 6-7, 9, 11, 40). As of the date of the IPO, the 1 million membership units had a value of \$20 per share, or \$20 million. Century admits that it was a member of Morgans, thereby undermining Century’s claim that Morgans received no consideration.

For the reasons above, Century's own allegations and the Prospectus upon which these allegations rely refute Century's claim that Morgan did not receive any consideration.

Accordingly, the court dismisses the fourth and fifth causes of action as against Morgans Co. and Morgans Group for failure to state a cause of action.

Leave to Replead

Century requests leave to replead, pursuant to CPLR 3025. Under CPLR 3025 (b), a court freely grants leave to amend. As Practice Commentary C3025:4 states, "[t]he policy is to permit amendment, for almost any purpose, as long as the adverse party cannot claim prejudice." (Siegel, Practice Commentaries, McKinney's Cons Laws of NY, Book 7B, CPLR C3025:4).

Here, the parties' agreements permit the breach of fiduciary duty claims if Century can allege bad faith. Moreover, permitting Century to replead its fraudulent conveyance claims will not prejudice defendants.

Accordingly, it is hereby

ORDERED that the motion to dismiss is granted and the second and third causes of action are dismissed in their entirety, the fourth and fifth causes of action are dismissed as to defendants Morgans Hotel Group Co. and Morgans Group LLC and the action is severed and dismissed as to defendants Morgans Hotel Group, Co. and Morgans Group LLC; and it is further

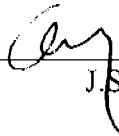
ORDERED that the plaintiff is directed to serve and file a second amended complaint so as to replead the second, third, fourth and fifth causes of action within 15 days after service on plaintiff's attorney of a copy of this order with notice of entry. In the event that plaintiff fails to serve and file an amended complaint within such time, leave to replead the second, third, fourth and fifth causes of action shall be deemed denied and the Clerk is directed to dismiss these

causes of action with prejudice; and it is further

ORDERED that the action in all other respects continues.

Dated: April 5, 2007

ENTER:



J.S.C.

FILED

APR 12 2007

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