

**Coventry Real Estate Advisors, LLC v Developers
Diversified Realty Corp.**

2012 NY Slip Op 33450(U)

May 22, 2012

Supreme Court, New York County

Docket Number: 115559/2009

Judge: Shirley Werner Kornreich

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

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COVENTRY REAL ESTATE ADVISORS, LLC,
et al.,

Index No. 115559/2009

Plaintiffs,

DECISION & ORDER

-against-

DEVELOPERS DIVERSIFIED REALTY
CORPORATION et al.,

Defendants.

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SHIRLEY WERNER KORNREICH, J.

Plaintiffs move (Mot. Seq. 006) to dismiss all of defendants' counterclaims. The facts relating to this case are more fully set forth in this court's prior decisions and orders, dated June 23 and December 8, 2010. Defined terms in the prior opinions shall have the same meaning here.

The motion is directed to the following causes of action, which are numbered here as they are in the counterclaims: 1) breach of the Main Fund's fiduciary duty to DDR; 2) CREA's aiding and abetting of the Main Fund's breaches of fiduciary duty; 3) breach of the LLC Agreements by the Main Fund; 4) tortious interference with DDR's business relationships by the Funds; and 5) business libel of DDR by the Funds and CREA. The record does not contain affidavits by persons with knowledge of the facts. Both sides rest on attorneys' affirmations that annex documentary evidence.

Breach of Fiduciary Duty & Aiding and Abetting

Defendants allege that the Main Fund had a fiduciary duty to DDR based upon the terms

of the LLC Agreements that governed the Property Owner REITs, which owned the Properties. The court has already ruled that the Main Fund had a fiduciary duty pursuant to §4.1 of the LLC Agreements. The ruling was affirmed on appeal. *Coventry Real Estate Advisors, L.L.C. v Developers Diversified Realty Corp.*, 84 AD3d 583 (1st Dept 2011). While plaintiffs urge that the fiduciary duty is owed only to the Property Owner REITs, the LLC Agreements provide that it is owed to “the Company and all of the Members.” DDR is a Member.

Defendants claim that the Main Fund breached its fiduciary duty to DDR by: 1) refusing to sell the Phoenix Spectrum Mall (Phoenix) to DDR or anyone else,¹ and refusing to sell other unspecified Properties, when the real estate market was declining; 2) using short-term financing for Bloomfield Park, claiming it had no money to make modest payments for loan forbearance on Ward Parkway and Service Merchandise, and using short-term recourse financing for Totem Lake Mall, Fairplain Plaza, Merriam Village and Bloomfield Park; and 3) failing to provide additional capital for the operation of Bloomfield Park and Tri-County Mall. The counterclaims allege in conclusory fashion that the same breaches of duty by the Main Fund occurred with respect to other unnamed Properties. DDR alleges that the Main Fund refused to sell because it wanted to maximize its own asset management fees by retaining the Properties; retained the Properties to obtain incentive payments that the Main Fund would earn after the Properties achieved a certain level of profitability; and did not provide capital for maintenance in order to obtain distributions of cash to cover the Main Fund’s overhead salaries and other expenses.

Plaintiffs argue that defendants have not stated a counterclaim for breach of fiduciary

¹DDR alleges that it offered to purchase Phoenix in 2007 for \$109.2 million and in March 2008 for \$95 million, and that, in May 2009, a financial advisor hired by Coventry recommended that it accept any offer over \$70 million. Counterclaims ¶26.

duty because defendants lack standing, since they sue individually, the counterclaim is derivative, and no demand on the Main Fund or particularized futility of demand was pleaded.² With respect to the merits, plaintiffs contend that no claim of breach of fiduciary duty is stated because: 1) defendants only pleaded the Main Fund's self-interest in refusing to sell; 2) defendants did not plead that the Main Fund voted against a proposal to sell; 3) the Main Fund was not required, under the LLC Agreements, to approve sales; 4) the Investment Committee, on which DDR and the Main Fund affiliates had equal votes, had to approve all financing; and 5) the maximum capital contribution the Funds were required to provide was met and the counterclaim does not allege unmet capital calls.

The law of the state of incorporation governs claims of breach of fiduciary duty owed by corporate managers. *Diamond v Oreamuno*, 24 NY2d 494, 503-504 (1969) ("The primary source of the law in this area ever remains that of the State which created the corporation."). All of the Property Owner REITs are Delaware limited liability companies. Consequently, the law of the state of Delaware applies to the counterclaim for breach of fiduciary duty.

Standing - Direct or Derivative Claims

Under Delaware law, the analysis of whether a claim is direct or derivative depends upon the answer to two questions: who was harmed and who will benefit from recovery. *Tooley v. Donaldson, Lufkin, & Jenrette, Inc.*, 845 A2d 1031 (Del. Sup Ct 2004); *Kelly v Blum*, 2010 Del. Ch. LEXIS 31, 2010 WL 629850 (Del Ch.)(nor). In Delaware, case law governing corporate derivative suits is applicable equally to suits on behalf of an LLC. *Kelly* at WL, p 9.

²Plaintiffs made the derivative claim argument for the first time in reply, but at oral argument, the court heard argument on it and accepted additional submissions on the issue from defendants' attorney. Tr 1/6/11, pp 12-13.

In order to assert a direct claim:

The stockholder's claimed direct injury must be independent of any alleged injury to the corporation. The stockholder must demonstrate that the duty breached was owed to the stockholder and that he or she can prevail without showing an injury to the corporation.

Tooley at 1039. In a derivative action on behalf of an LLC, the complaint must "set forth with particularity the effort, if any, of the plaintiff to secure initiation of the action by a manager or member or the reasons for not making the effort." 6 Del. C. § 18-1003. In both *Tooley* and *Kelly*, the courts found a fiduciary duty was owed by management to the minority shareholder or member, and that a claim that a merger price was unfair was an individual, not derivative, claim. In a merger situation, an individual shareholder has a right to sell his or her privately-owned shares for a particular price.

Here, although the Main Fund owed a fiduciary duty to DDR, the counterclaims are derivative because any recovery would belong to the Property Owner REITs. The counterclaims allege that the refusal to sell damaged the Property Owner REITs and its members, including DDR. Counterclaims ¶28.³ While DDR argues that only DDR and the Main Fund were members, any potential recovery would belong to the Property Owner REITs, not their individual members.⁴ The same is true with respect to the alleged refusal to obtain long-term, non-recourse

³To the extent that the counterclaims allege the Main Fund's refused to sell Phoenix to DDR when the market was declining, it appears that DDR was not damaged. In 2009, Coventry's financial advisor recommended that Phoenix be sold for \$25 million less than DDR's lowest prior offer. Counterclaims ¶26.

⁴Although it is not necessary to reach the merits of the claim of refusal to sell, the court notes that DDR's claim that the Main Fund had veto power is incorrect. The Coventry members of the Investment Committee had the power to override DDR's members on the decision *to sell*, not the decision to retain the Properties.

financing⁵ and to provide capital for maintenance. The recovery, if any, would go to the Property Owner REITs; the claims are derivative. Since the counterclaims do not plead a demand or futility of demand, defendants' counterclaim for breach of fiduciary is dismissed for lack of standing. 6 Del. C. § 18-1003.

The second counterclaim for aiding and abetting also is dismissed due to the dismissal of the claim for breach of fiduciary duty. In addition, the second counterclaim is insufficient because it does not state what CREA did to aid and abet. To state a claim under Delaware Law, the complaint must allege knowing participation in the breach of fiduciary duty. *Kelly* at WL p15. There are no facts alleged to support knowing participation by CREA.

Breach of the LLC Agreements

The third counterclaim alleges that plaintiffs breached the LLC Agreements by assuming leasing responsibilities that were delegated exclusively to DDR. Plaintiffs move to dismiss on the grounds that DDR refused to perform its duties, thereby permitting plaintiffs to engage in leasing to mitigate damages, and that DDR cannot prove damages because they continued to receive property management fees.

The motion to dismiss the third counterclaim for breach of contract is denied. Whether plaintiffs took over after DDR breached its leasing responsibilities is a contested issue of fact that cannot be resolved in defendants' favor on a motion to dismiss. *Cron v Hargro Fabrics*, 91 NY2d 362, 366 (1998). Moreover, damages not recompensed through management fees are alleged. For example, defendants allege that plaintiffs negotiated a lease amendment to reduce a

⁵The damages with respect to nonrecourse financing are alleged to have jeopardized the entire Coventry Fund II Portfolio, i.e., all of the Properties owned by the Property Owner REITs. Counterclaims ¶¶ 34-38.

tenant's rent, when the tenant would have paid the higher rent reserved in the lease.

Counterclaim ¶48.

Tortious Interference with Business Relationships & Business Libel

DDR alleges in the fourth counterclaim that Coventry interfered with DDR's business relationships by negotiating leases and advocating DDR's termination as property manager. DDR claims that Coventry made accusations about DDR's alleged misconduct to the loan agent for Eurohypo, a lender's agent for Service Merchandise, suggesting that Eurohypo investigate and terminate DDR as property manager, and told Aegon, the lender for plaintiff Buena Park LLC, that it should terminate DDR as property manager. The fifth counterclaim alleges that the statements were false and made intentionally with ill will or malice in order to harm DDR's reputation. The parties only cited New York law.

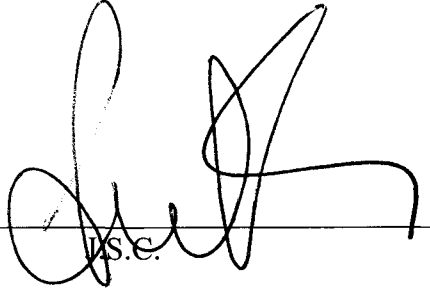
The motion to dismiss these two tort claims is denied with leave to renew. In the context of tort law, New York utilizes interest analysis to determine which jurisdiction has the greater interest in having its law applied in the litigation. *Padula v Lilarn Properties Corp.*, 84 NY2d 519, 521 (1994). The alleged injured party is DDR, an Ohio corporation with its principal place of business in Ohio. Counterclaims ¶6. The interference claim relates to leasing negotiations with Bed Bath & Beyond (BBB), A. C. Moore, Petsmart and Buy Buy Baby. The libel claim relates to communications with BBB, Eurohypo and Aegon. The counterclaims allege that "BBB operates over 1,000 stores in the U.S. and Canada and currently leases space at over 50 DDR properties." Counterclaims ¶52. A. C. Moore is a Service Merchandise tenant in North Carolina. Counterclaims ¶48. Service Merchandise has 51 locations and is a Delaware LLC. Counterclaims ¶14, Complaint ¶11. Coventry allegedly contacted a Petsmart broker in Delaware.

Counterclaims ¶49. Aegon is the lender for the Buena Park Mall in California, which is owned by Coventry II DDR Buena Park LLC, a Delaware LLC. Counterclaims ¶15, Complaint ¶11. Coventry allegedly attempted to lease a Property to Buy Buy Baby and in the process maligned DDR to a Tennessee broker. Counterclaims ¶46. The record does not reveal where the events involving Eurohypo took place. The parties' submissions do not address choice of law. Therefore, plaintiffs may renew the motion to dismiss these two counterclaims. Accordingly, it is

ORDERED that the motion by plaintiffs to dismiss defendants' counterclaims is granted as to the first and second causes of action for breach of fiduciary duty and aiding and abetting breach of fiduciary duty, which are dismissed; denied as to the third cause of action for breach of contract; and denied with leave to renew as to the fourth cause of action for interference with business relations and the fifth cause of action for business libel.

Dated: May 22, 2012

ENTER:



A handwritten signature in black ink, written over a horizontal line. The signature is highly stylized and cursive. Below the signature, the letters "U.S.C." are printed in a small, serif font.