SUPREME COURT OF THE STATE OF NEW YORK
NEW YORK COUNTY

PRESENT: MELVIN L. SCHWEITZER Justice PART 45

DAVID LICHTENSTEIN, et al

-v-

WILLKIE FARR + GALLAGHER LLP, et al

INDEX NO. 652092/12

MOTION DATE

MOTION SEQ. NO. 001

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

Notice of Motion/Order to Show Cause — Affidavits — Exhibits ____ No(s). ____

Answering Affidavits — Exhibits ____ No(s). ____

Replying Affidavits ____ No(s). ____

Upon the foregoing papers, it is ordered that this motion ~~to~~ by defendants to dismiss the complaint is GRANTED per the attached Decision and Order.

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

Dated: April 22, 2013

MELVIN L. SCHWEITZER

1. CHECK ONE: ..... ☑ CASE DISPOSED ☐ NON-FINAL DISPOSITION
2. CHECK AS APPROPRIATE: .....MOTION IS: ☑ GRANTED ☐ DENIED ☐ GRANTED IN PART ☐ OTHER
3. CHECK IF APPROPRIATE: ..... ☐ SETTLE ORDER ☐ SUBMIT ORDER
☐ DO NOT POST ☐ FIDUCIARY APPOINTMENT ☐ REFERENCE

SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK : PART 45

DAVID LICHTENSTEIN, THE LIGHTSTONE GROUP, LLC, and LIGHTSTONE HOLDINGS, LLC.,	:	
Plaintiffs,	:	Index No. 652092/12
-against-	:	DECISION AND ORDER
WILLKIE FARR & GALLAGHER LLP, MARC ABRAMS, MATTHEW FELDMAN, and MARGOT SCHONHOLTZ,	:	Motion Sequence No. 001
Defendants.	:	

MELVIN L. SCHWEITZER, J.:

Preliminary Statement

Plaintiffs David Lichtenstein (Mr. Lichtenstein), The Lightstone Group, LLC, and Lightstone Holdings, LLC (Lightstone), bring this action against Willkie Farr & Gallagher LLP (Willkie), alleging legal malpractice and breach of fiduciary duty. Willkie moves to dismiss the complaint pursuant to CPLR 3211 (a) (7) for failure to state a cause of action.

Background

In 2007, Mr. Lichtenstein and Lightstone, together with other investors, purchased Extended Stay, Inc. (ESI), which owned and managed hotels, for approximately $8 billion. Mr. Lichtenstein managed ESI, and served as its CEO and Board Chairman.

In addition to an equity investment, the acquisition was financed through $4.1 billion in mortgage loans to ESI, and $3.3 billion in ten mezzanine loan tranches to ESI subsidiaries. The loan documents contained eleven personal guarantees signed by Mr. Lichtenstein. The guarantees provided for $100 million of liability for Mr. Lichtenstein and Lightstone to the

lenders in the event of certain acts within their control, including the voluntary filing of a bankruptcy petition by ESI.

Soon after the purchase, as the overall economy suffered, the financial situation of ESI declined. By late 2008 it faced a liquidity crisis and retained Weil, Gotshal & Manges LLP (Weil) to advise it in connection with its restructuring efforts. Weil suggested Mr. Lichtenstein retain Willkie to advise him in connection with his role as an officer and director of ESI. Mr. Lichtenstein retained Willkie for this purpose. Willkie's representation of Mr. Lichtenstein was handled primarily by partners Marc Abrams (Mr. Abrams) and Matthew Feldman (Mr. Feldman).

As the financial condition of ESI further declined, Mr. Lichtenstein was faced with two options – ESI could either file for bankruptcy – in which case the guarantees would cause Mr. Lichtenstein to be liable for $100,000,000 – , or seek an alternative. The alternative was to refuse to authorize, or at least delay, a bankruptcy filing, and thereby force the lenders to file a petition for involuntary bankruptcy, or foreclose on its collateral. In the case of the alternative, Mr. Lichtenstein would risk liability for breach of fiduciary duty.

The complaint alleges that in its representation of ESI: "Weil Gotshal recommended that ESI file for bankruptcy and claimed that the board members, including Mr. Lichtenstein, had an obligation as fiduciaries to achieve that result."

The complaint alleges that Mr. Abrams and Mr. Feldman "made full-throated warnings" that Mr. Lichtenstein risked drastic personal exposure if he did not authorize a bankruptcy filing. This advice, the complaint alleges, was wrong because Mr. Lichtenstein would prevail in any lawsuit for breach of fiduciary duty. Mr. Lichtenstein asserts that because the lenders had

insisted on a "bankruptcy remote" architecture in structuring the loans to ESI, this meant that Mr. Lichtenstein did not owe them a fiduciary duty to cause ESI to file a bankruptcy petition.

The complaint alleges that Willkie did not disclose to Mr. Lichtenstein the "fundamental self-interest" that motivated its allegedly erroneous advice. In any contractual claim against Mr. Lichtenstein, Willkie would not face a lawsuit by the lenders, but in a breach of fiduciary duty claim, Willkie faced exposure to the lenders under an aiding and abetting theory, if Willkie advocated a legal justification for Mr. Lichtenstein not putting ESI into bankruptcy.

According to the complaint, Mr. Lichtenstein offered to turn over the collateral to the lenders. Certain lenders refused to accept the collateral, and brought an action to block this transaction. This, the complaint alleges, was likely an effort to force ESI into a voluntary bankruptcy and trigger the guarantees. Mr. Abrams continued to insist that Mr. Lichtenstein's fiduciary duty demanded that he authorize ESI to file a bankruptcy petition. Mr. Abrams again warned Mr. Lichtenstein that if ESI did not file, he faced uncapped personal liability in a breach of fiduciary duty action initiated by the lenders. Pressed by Mr. Abrams to file, Mr. Lichtenstein resisted because he felt it did not make sense for ESI to voluntarily file for bankruptcy when the lenders had refused to accept the collateral, and filing for bankruptcy was an act which triggered $100,000,000 of contractual liability.

Then, according to Mr. Lichtenstein, a tipping point was reached, and ESI collapsed operationally and financially – it had entered a death spiral. Mr. Lichtenstein said:

> I determined that a voluntary bankruptcy petition was the only way to preserve and maximize the value of ESI for its creditors and to avoid massive operational layoffs to its workforce of over 10,000 employees. *Aware [my] fiduciary duties left [me] no other choice, [I] authorized ESI to file for bankruptcy....*

On June 15, 2009, ESI filed for bankruptcy. The complaint alleges that Mr. Abrams made various representations about how the lenders would positively view the filing, which later turned out not to be true. He predicted that the lenders might mitigate Mr. Lichtenstein's liability under the guarantees, and that, in any case, a lawsuit to enforce the guarantees would probably not immediately be filed by the lenders. Instead "the Lenders raced to courthouse" to enforce the guarantees, and the first lender filed on June 16th, 2009, one day after ESI's bankruptcy filing.

The complaint alleges that Willkie's advice was also negligent because it failed to consider the impact of insurance coverage on Mr. Lichtenstein's position. Mr. Lichtenstein had no insurance coverage for the $100,000,000 of guarantee liability, but he did have $50,000,000 of insurance coverage with respect to breach of fiduciary duty claims.

Discussion

On a motion to dismiss for failure to state a cause of action, the court accepts all factual allegations pleaded in plaintiff's complaint as true, and gives plaintiff the benefit of every favorable inference. CPLR 3211 (a) (7); *Sheila C. v Povich*, 11 AD3d 120 (1st Dept 2004). The court must determine whether "from the [complaint's] four corners[,] 'factual allegations are discerned which taken together manifest any cause of action cognizable at law." *Gorelik v Mount Sinai Hosp. Ctr.*, 19 AD3d 319 (1st Dept 2005) (quoting *Guggenheimer v Ginzburg*, 43 NY2d 268, 275 (1977)). Vague and conclusory allegations are not sufficient to sustain a cause of action. *Fowler v American Lawyer Media, Inc.*, 306 AD2d 113 (1st Dept 2003).

Legal Malpractice

To allege a claim of malpractice, a plaintiff must establish first "that the defendant attorney failed to exercise the ordinary reasonable skill and knowledge commonly possessed by

a member of the legal profession which results in actual damages to a plaintiff" and second, "that the plaintiff would have succeeded on the merits of the underlying action 'but for' the attorney's negligence" *AmBase Corp. v Davis Polk and Wardwell*, 8 NY2d 428, 434 (2007).

The complaint alleges that Willkie embraced Weil's erroneous view that the board members, including Mr. Lichtenstein, were obligated as fiduciaries to have ESI file for bankruptcy. This advice was allegedly erroneous because Mr. Lichtenstein "would ultimately prevail" in any breach of fiduciary duty suit. "In particular, the lenders had insisted on a 'bankruptcy remote' architecture in structuring the loans, and, as such, Willkie failed to advise Mr. Lichtenstein that he held no fiduciary duty to these very same creditors to file for bankruptcy." The complaint alleges that Willkie's warning to Mr. Lichtenstein that he would face uncapped personal liability in the case of a breach of fiduciary duty claim was incorrect. The complaint further alleges that Willkie, because of its negligence and self-interested motives, "failed to provide plaintiffs with independent representation using the degree of care, skill and prudence commonly possessed by members of the legal profession, and wrongfully advised Lichtenstein that he had no legal alternative but to have ESI file a bankruptcy petition."

Plaintiffs are correct to the extent that their argument is that the directors of Delaware corporations do not owe creditors any direct fiduciary duty. *See N. Am. Catholic Educ. Programming Found., Inc. v Gheewalla*, 930 A2d 92, 103 (Del. 2007) ("[I]ndividual creditors of an insolvent corporation have no right to assert direct claims for breach of fiduciary duty against corporate directors."). Directors owe fiduciary duties solely to the corporation and its shareholders. Plaintiffs err, however, when they equate fiduciary duty with standing to bring suit.

In the case of a solvent corporation, breaches of fiduciary duty may be redressed by shareholders bringing a derivative claim against the corporation's directors. *N. Am. Catholic Educ. Programming Found., Inc. v Gheewalla*, 930 A2d 92, 101 (Del. 2007). But, "[w]hen a corporation is *insolvent* . . . its creditors take the place of shareholders as residual beneficiaries of any increase in value. The creditors of *insolvent* corporations have standing to maintain derivative claims against directors on behalf of the corporation for breaches of fiduciary duties." *N. Am. Catholic Educ. Programming Found., Inc. v Gheewalla*, 930 A2d 92, 101 (Del. 2007).

The pleadings clearly establish that ESI was insolvent. As ESI's financial and operating status deteriorated, there were only two options. Under either option, ESI would have been placed in bankruptcy. Plaintiffs do not suggest that another was possible.

"Bankruptcy remote", whatever the term may mean – and plaintiffs do not define it – is not a freestanding proposition of law that insulates Mr. Lichtenstein from liability. This would run contrary to Delaware law, which enjoins waiving or limiting a director's liability "for any breach of the duty of loyalty to the corporation or its stockholders." DGCL 102 (b) (7).

The duty of loyalty to the corporation cannot be altered by an opaque contractual arrangement between sophisticated parties which does not address pertinent issues. Thus, legal "slang" such as "bad boy" and "bankruptcy remote" only serves to underscore the frivolous nature of plaintiff's argument that a bedrock governance principle of Delaware law was nullified by the architecture of the transaction. Were a derivative action to have been brought under Delaware law by *any creditor – not just a lender* – which alleged a breach of the duty of loyalty, Mr. Lichtenstein, a fiduciary of ESI, would have been required to face uncapped liability regarding the measure of waste.

Under Delaware law, the "classic example" of what constitutes a breach of the duty of loyalty and the standard employed in determining whether there exists such a breach, is when a fiduciary is conflicted or is self-dealing. *In re Walt Disney Co. Derivative Litig.*, 907 A2d 693, 751 (Del. Ch. 2005) *affd*, 906 A2d 27 (Del. 2006). The duty of loyalty "also encompasses cases where the fiduciary fails to act in good faith." *Stone ex rel. AmSouth Bancorporation v Ritter*, 911 A2d 362, 370 Del. 2006. "The Delaware Supreme Court has implicitly held that committing waste is an act of bad faith." *In re Walt Disney Co. Derivative Litig.*, 907 A2d 693, 749 (Del. Ch. 2005) (citing *White v Panic*, 783 A2d 543, 553-55 (Del.2001).

Delaware plaintiffs bringing claims of corporate waste face an "onerous" standard. *In re Walt Disney Co. Derivative Litig.*, 906 A2d 27, 73 (Del. 2006). For fiduciaries to commit corporate waste, they must "exchange ... corporate assets for consideration so disproportionately small as to lie beyond the range at which any reasonable person might be willing to trade." *Lewis v Vogelstein*, 699 A2d 327, 336 (Del. Ch. 1997).

Mr. Lichtenstein, represented by counsel other than Willkie, admitted the bankruptcy filing was necessary to prevent waste of ESI's assets.

In this vein, it has been recognized that a director faces personal liability for a duty of loyalty violation in the precise circumstances in which Mr. Lichtenstein found himself. Where a fiduciary (as Mr. Lichtenstein admits he was) fails to file for bankruptcy or delays filing in order to serve his personal interest, such as to avoid liability under a guaranty, and the corporation's value is diminished as a result, he faces uncapped personal liability. *In re USA Detergents, Inc.*, 418 B.R. 533, 536-39 (Bankr. D. Del. 2009).

There is no need to go to the second prong of the malpractice action because Mr. Lichtenstein's claim, on its face, does not plead the first prong. Willkie was not negligent.

It provided advice consistent with "ordinary reasonable skill and knowledge commonly possessed by a member of the legal profession." *AmBase Corp. v Davis Polk and Wardwell*, 8 NY3d 428, 434 (2007).

Breach of Fiduciary Duty

A cause of action for breach of fiduciary duty must be dismissed where it is redundant of a cause of action for legal malpractice, i.e., if "they arise from the same allegations and seek identical relief." *Sun Graphics Corp. v Levy, Davis & Maher, LLP*, 94 AD3d 669, 669 (1st Dept 2012). This cause of action fails because it is based on the same alleged wrongdoing by Willkie as the cause of action for legal malpractice, and it seeks to recover the same alleged damages.

The elements of a cause of action for breach of fiduciary duty arising out of an attorney's performance are identical to those for legal malpractice. *Weil, Gotshal & Manges, LLP v Fashion Boutique*, 10 AD3d 267, 271-72 (1st Dept 2004). The complaint thus fails to state a cause of action for breach of fiduciary duty for the same reasons that it fails to state a cause of action for malpractice.

ORDERED that defendants' motion to dismiss is granted.

Dated: April 22, 2013

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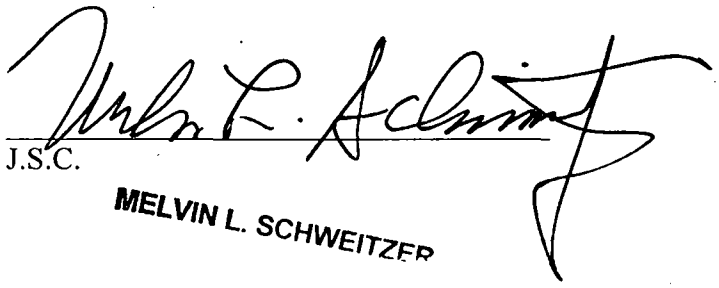

J.S.C.

MELVIN L. SCHWEITZER