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

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JOSH REAVES, Derivatively on Behalf of RESOURCE CAPITAL CORP.,

Plaintiff,

-against-

STEVEN KESSLER, EDWARD E. COHEN, JONATHAN Z. COHEN, WALTER T. BEACH, WILLIAM B. HART, GARY ICKOWICZ, MURRAY S. LEVIN, P. SHERILL NEFF, RICHARD L. FORE, STEPHANIE H. WIGGINS, DAVID J. BRYANT, and ELDRON C. BACKWELL,

Defendants,

-and-

RESOURCE CAPITAL CORP.,

Nominal Defendant.

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DECISION AND ORDER

Index No. 654485/2015

Mot. Seq. 001-002

HON. ANIL C. SINGH, J.:

Plaintiffs move for an order consolidating four actions pursuant to CPLR 602 and appointing lead counsel in the consolidated action.[1] Defendants cross-move to stay the actions pursuant to CPLR 2201 based on the pendency of an action in federal court.

Four related shareholder derivative actions are pending in this court: 1) Reaves v. Kessler, et al., Index No. 654485/2015 (filed Dec. 30, 2015) (the "Reaves action"

[1]Motion sequence 001 and 002 are consolidated for disposition.

or the "first action"); 2) Caito v. Kessler, et al., Index No. 650890/2017 (filed Feb. 21, 2017); 3) Simpson v. Bryant, et al., Index No. 651172/2017 (filed March 6, 2017); and 4) Heckel v. Bryant, et al., Index No. 651187/2017 (filed March 7, 2017) (collectively, the "related state derivative actions").

On September 9, 2015, a federal "stock drop" securities class action was filed in the Southern District of New York for violations of federal securities laws (Levin v. Resource Capital Corp., No. 1:15-cv-07081-LLS (S.D.N.Y.) (the "Levin class action")). At least nine "tag-along" shareholder derivative complaints have followed: five filed in the United States District Court for the Southern District of New York (the "federal derivative lawsuits"), and the four related state derivative actions filed in this Court. The first federal derivative action was filed in 2017 (NYSCEF Doc. No. 47, p. 9).

On October 5, 2016, U.S. District Judge Louis L. Stanton denied a motion to dismiss the Levin class action.

Factual Allegations

This is a set of shareholder derivative actions commenced by shareholders on behalf of nominal defendant Resource Capital Corp. ("Resource Capital" or the "company"), against certain officers and directors for breaches of fiduciary duty, and against related parties Resource Capital Manager, Inc. ("Resource Manager") and

Resource America, Inc. ("Resource America") for unjust enrichment.

Resource Capital is a real estate investment trust ("REIT") that is externally managed by Resource Manager, an indirect wholly-owned subsidiary of Resource America, an asset management company. Neither the company nor Resource Manager has any exclusively dedicated employees. Rather, all of Resource Capital's and Resource Manager's officers, portfolio managers, administrative personnel, and other employees are employees of Resource America.

Until September 8, 2016, defendants Edward Cohen and Jonathan Cohen (collectively, the "Cohens") were Resource America's largest stockholders, beneficially owning approximately 30% of its shares. Although the Cohens are now retired from Resource Capital's board of directors, they still allegedly control the company through their appointment of the current board members, who are all allegedly loyal to and dependent upon them. Plaintiffs contend that Resource America and Resource Manager (which are both allegedly dominated by the Cohens) have significant discretion as to the implementation of Resource Capital's operating policies and investment strategies.

The actions allege that the Cohens and certain other defendants engaged in a course of conduct designed to enrich Resource America at Resource Capital's expense, through excessive and undeserved management fees. First, the board agreed to pay

Resource Manager a monthly base management fee equal to one-twelfth of the company's equity, regardless of performance. Second, the board concealed for years that one of the company's mezzanine loan positions, which it acquired in 2007 (the "mezzanine loan"), was largely supported by a portfolio of luxury brand hotels located in or near Puerto Rico. Third, the board repeatedly caused or allowed the company to improperly brag that all of the company's commercial real estate loans were performing for years during the collapse of the Puerto Rican economy, continuing long after the mezzanine loan stopped performing in 2012. Plaintiffs allege that the defendants' wrongful course of conduct improperly inflated the company's apparent equity from late 2012 through the first half of 2015, in turn improperly inflating the management fees the company paid to Resource Manager during that time to an average of approximately $13.7 million per year.

On August 4, 2015, after the stock market closed, Resource Capital issued a press release announcing its financial results for the quarter ended June 30, 2015. Following numerous alleged improper statements concerning the company's financial condition and loan portfolio, Resource Capital disclosed that it would incur a quarterly net loss of $31 million due primarily to a $41.1 million loan loss on the mezzanine loan. As disclosed in the press release, major disruptions in Puerto Rico's economy caused the company to determine that the mezzanine loan should have been fully

reserved. As a consequence of this disclosure, Resource Capital's stock fell 14.66%, eradicating over $68.4 million in market capitalization. Had the company timely recorded the loss in late 2012, when the mezzanine loan stopped performing, a similar decline in equity would presumably have occurred then, causing Resource Capital to pay far less in management fees from the fourth quarter of 2013 through the first quarter of 2015.

Plaintiffs allege that Resource Capital's directors and officers breached their fiduciary duties by: 1) misrepresenting, and causing the company to misrepresent to the investing public, the risk of the company's commercial loans portfolio, its process and controls for assessing the quality and value of that portfolio; 2) by failing to maintain for the company adequate internal and financial controls; 3) by failing to disclose, and causing the company to fail to disclose to the investing public, that the company lacked adequate internal and financial controls; and 4) causing the company to pay excessive management fees.

The complaints assert causes of action for breach of fiduciary duty and unjust enrichment.

Cross-Motion to Stay the Actions Pursuant to CPLR 2201

CPLR 2201 provides that "the court in which an action is pending may grant a stay of proceedings in a proper case, upon such terms as may be just." The decision

is discretionary (Britt v. International Bus Services, Inc., 255 A.D.2d 143 [1st Dept., 1998]). A stay should be granted pending determination of a related proceeding when the other proceeding shares complete identity of parties, claims and relief sought (see Asher v. Abbott Labs., 307 A.D.2d 211, 211 (1st Dept., 2003)).

A court has broad discretion to issue a stay particularly where the stay would "avoid the risk of inconsistent adjudications, application of proof, and potential waste of judicial resources" (In re Tenenbaum, 81 A.D.3d 738, 739 (2d Dept., 2011); see also One Beacon Am. Ins. Co. v. Colgate-Palmolive Co., 96 A.D.3d 541, 541 (1st Dept., 2012) ("The duplication of effort, waste of judicial resources, and possibility of inconsistent rulings in the absence of a stay outweigh any prejudice to plaintiff resulting from the [stay]")). A stay is appropriate even where there is not complete identity of parties and claims where there is a common question of law and fact (Uptown Healthcare Mgt., Inc. v. Rivkin Radler LLP, 116 A.D.3d 631 (1st Dept., 2014); Belopolsky v. Renew Data Corp., 41 A.D.3d 322 (1st Dept., 2007)).

Under appropriate circumstances, including the existence of an identity of issues and parties, an action in state court may be stayed where there is another action pending in federal court (Certain Underwriters at Lloyd's London v. Pneumo Abex Corp., 36 A.D.3d 441 [1st Dept., 2007]). In such a situation, the issuance of a stay is not a matter of right; rather, it is a matter of comity, orderly procedure and judicial

discretion (General Aniline & Film Corp. v. Bayer Co., 305 N.Y. 479 [1953]). Additionally, a stay may be granted, even though defendants have not yet interposed answers (see Britt, 255 A.D.2d at 143). Finally, in determining whether to issue a stay, a court may consider multiple additional factors.[2]

Plaintiffs' first contention is that they will be unduly prejudiced if the Court grants a stay. Specifically, plaintiffs contend that the federal lawsuits are weaker than the complaint filed in the Reaves action because at the time the federal derivative lawsuits were filed, two of the most culpable defendants, Edward Cohen and Jonathan Cohen, were already off the Resource Capital board. Emphasizing that demand futility is assessed as to the directors on the board when the action is filed, the Reaves action was the only action that placed real litigation pressure on defendants – and the only action capable of doing so – by alleging demand futility upon a board that included the most culpable defendants on the board, the Cohens. Accordingly, as the Reaves action is the action least susceptible to dismissal of all the derivative actions, defendants moved to stay the Reaves action in favor of the substantively weaker federal derivative

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[2]These factors include whether it is in the state or in the federal forum that a more complete disposition of issues may be obtained; whether it is the federal or the state court that possesses a greater familiarity with the trial of such issues; whether the federal action was commenced first and discovery has been completed; whether the defendants in the actions are the same; whether there is substantial overlap between the issues raised in the two proceedings; whether a stay will avoid duplication of effort and waste of judicial resources; whether a stay will avoid the risk of inconsistent rulings; and whether plaintiffs have demonstrated how they would be prejudiced by a stay (Asher, 307 A.D.2d at 211-12).

lawsuits for the primary purpose of gaining an insurmountable tactical advantage over plaintiffs.

There is no New York case law explicitly stating that this Court must compare the federal action to the state action on the merits to make a preliminary determination as to which party is more likely to prevail. The cases cited above do not list it as a factor to consider on an application for a stay. Therefore, this Court will not consider the merits of each action in making its determination.

Plaintiffs' second contention is that the claims under section 14(a) of the federal Exchange Act in the federal derivative lawsuits are meritless and do not broaden the federal lawsuits. Specifically, plaintiffs assert that federal courts routinely dismiss "proxy fraud" claims under section 14(a) of the Exchange Act on the grounds "that stockholders may assert meritless 14(a) claims for the sole purpose of invoking federal jurisdiction" (Galef v. Alexander, 615 F.2d 51, 66 n.24 (2d Cir. 1980). Accordingly, plaintiffs contend that there is a strong inference that the federal derivative lawsuits tacked on meritless Section 14(a) claims to fabricate federal jurisdiction and do not broaden the federal derivative suits.

Plaintiffs are engaging in hyperbole in asserting that the proxy fraud claims are "patently meritless." The genesis of plaintiffs' assertion is a footnote in Galef, supra. However, plaintiffs fail to quote the entire footnote, which states in its entirety:

> We recognize the possibility that stockholders may assert meritless s 14(a) claims for the sole purpose of invoking federal jurisdiction. But this risk should be lessened by Fed.R.Civ.P. 11, which requires that the pleading of a party represented by counsel be signed by at least one attorney in his individual name, and which further provides:
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> > The signature of an attorney constitutes a certificate by him that he has read the pleading; that to the best of his knowledge, information and belief there is good ground to support it; and that it is not interposed for delay.... For a wilful violation of this rule an attorney may be subjected to appropriate disciplinary action.

(Galef, 615 F.2d at 66, footnote 24).

On this record, there is no reasonable basis for the Court to assume that the federal proxy fraud claims are meritless and that the Section 14(a) claims do not broaden the federal suits.

In addition to the claims asserted in the state cases, the federal shareholder derivative actions involve a proxy fraud claim under Section 14(a) of the Exchange Act. The federal court has "exclusive jurisdiction" over such claims (see 15 U.S.C. section 78aa). Accordingly, as the federal court is the only court that has jurisdiction over every claim asserted by the derivative plaintiffs, the federal court can provide a more complete disposition of the claims at issue (see Barron v. Bluhdorn, 68 A.D.2d 809, 810 [1st Dept., 1979]); Theatre Confections, Inc. v. Andrea Theaters, Inc., 126 A.D.2d 969, 970 [4th Dept., 1987] (action stayed as federal court had exclusive jurisdiction over issue involving federal antitrust laws); Chan v. Zoullas, 34 Misc.3d

1210(A) [Sup. Ct. N.Y. Cnty., 2012], at *3-4 (stay proper where "the decision in one action will determine all the questions in the other action or will, at least, reduce the issues in the other action[]"); El Greco, Inc. v. Cohn, 139 A.D.2d 615 [2d Dept., 1988] (staying action where the "record discloses that a more complete disposition of the parties' respective contentions can be obtained in the earlier-commenced federal action").

Plaintiffs' third contention is that the Reaves action was filed in this Court before any of the federal derivative lawsuits. As this Court was the first which has taken jurisdiction, New York's first-filed doctrine dictates that this court "is the one in which the matter should be determined and it is a violation of the rules of comity to interfere" (In re Perceptron, Inc. (Vogelsong), 34 A.D.3d 1215 [4th Dept., 2006]). Vogelsong involved a proceeding to vacate an arbitration award and to enjoin an action brought in Michigan to enforce the award. Accordingly, it is clearly distinguishable from the instant matter.

However, the first-filed rule, which gives precedence to the court in which an action is first commenced should not be mechanically applied (ACE Fire Underwriters Ins. Co. v. ITT Industries, Inc., 44 A.D.3d 404, 405 (1st Dept., 2007). Rather, the court may look to factors outside of the first-filed rule in making its determination as to whether this court should grant a stay. See generally, In re NYSE Euronext

Shareholders/ICE Litigation, 39 Misc.3d 619, 625 (Sup. Ct. N.Y. Cnty., Mar. 1, 2013). As discussed, *supra*, the federal courts have exclusive jurisdiction under Section 14(a) of the Exchange Act. Therefore, the federal courts can provide a more complete disposition of the claims at issue. This factual determination weighs heavily in favor of issuing a stay in this proceeding.

Plaintiffs' fourth contention is that the determination of whether demand was futile as to a majority of the board will necessarily require different analyses in the state and federal actions. At the time the first derivative action was filed in state court, Resource Capital's board consisted of ten defendant directors: the Cohens, Kessler, Beach, Hart, Ickowicz, Levin, Neff, Fore, and Wiggins. However, at the time the first derivative action was filed in federal court, Resource Capital's board consisted of nine directors: Kessler, Levin, Neff, Beach, Hart, Ickowicz, Fore, Wiggins, and non-defendant directors Andrew L. Farkas and Jeffrey P. Cohen.

As there is no case law stating this Court must weigh the relative merits of the federal action and the state action as a factor in determining whether to impose a stay, this court will not deny a stay based upon the substantive merits of each action.

Plaintiffs' final contention is that a stay may not be granted until both the state derivative lawsuits and the federal derivative lawsuits are fully at issue. Plaintiffs assert that, until both actions are fully at issue, it is impossible to say that a

determination in one action will dispose of the other.

The Court has the discretion to grant a stay even when issue is not joined (Kayser v. Horton, 42 A.D.2d 839 [4th Dept., 1973]). Ultimately, a majority of the factors weigh in favor of a stay. Because the federal court has exclusive jurisdiction over the Section 14(a) claims under the Exchange Act, the federal court will provide a more complete disposition of the claims. A stay avoids the risk of inconsistent rulings, duplication of effort, and waste of judicial resources. See One Beacon, 96 A.D.3d at 541. For the reasons discussed, *supra*, the Court is not convinced that plaintiffs will suffer undue prejudice as a result of a stay. The Reaves action was the first action filed, but the Court in its discretion finds that is not a sufficient reason to deny the stay under the specific circumstances of this case.

Plaintiffs' Motions to Consolidate Actions

CPLR 602 provides that a party may move to consolidate "actions involving a common question of law or fact" into a single action. As a general rule, New York courts favor consolidation as a matter of public policy (Geneva Temps, Inc. v. New World Communities, Inc., 24 A.D.3d 332 [1st Dept., 2005] (noting that "there is a preference for consolidation in the interest of judicial economy where there are common questions of law and fact.")). Consolidation reduces calendar delays, results in judicial economy, eliminates the problem of inconsistent results, avoids duplication

of discovery, and reduces legal expense and inconvenience to witnesses (Amcan Holdings, Inc. v. Torys LLP, 32 A.D.3d 337 [1st Dept., 2006] (emphasizing that consolidation was particularly appropriate when it was "probable that injustice would result" from inconsistent outcomes in the two actions)). Although consolidated actions need not share every factual or legal issue, there must be identity of issues (id.).

Here, it is undisputed that the actions allege virtually identical facts in support of substantially identical claims against nearly identical defendants. Defendants do not oppose consolidation.

If the actions are consolidated, plaintiffs request that the consolidated case be assigned the master caption "In re Resource Capital Corp. Shareholder Derivative Litigation, Master Index No. 654485/2015." They contend that the request is consistent with the court's authority to manage its docket and would further promote judicial economy and efficiency.

Plaintiffs have made a persuasive argument in favor of consolidation, so the application to consolidate is granted.

Motions to Appoint Lead Counsel

The stay of this action will bring the litigation in this Court to a complete halt while the litigation proceeds in federal court. Because nothing can happen in this court from this point forward, it would serve no useful purpose for the Court to appoint lead

counsel at this stage. The issue is moot.

Accordingly, it is

ORDERED that defendants' cross-motion to stay the actions is granted to the extent of staying further proceedings in the actions, except for an application to vacate or modify the stay; and it is further

ORDERED that the parties may make an application by order to show cause to vacate or modify this stay upon the final determination of the action pending in federal court; and it is further

ORDERED that the motions to appoint lead counsel are denied as moot; and it is further

ORDERED that the motion to consolidate is granted, and the above-captioned action is consolidated in this Court with Caito v. Kessler, et al., Index No. 650890/2017; Simpson v. Bryant, et al., Index No. 651172/2017; and Heckel v. Bryant, et al., Index No. 651187/2017, under Index No. 654485/2015, and the consolidated action shall be assigned the master caption In re Resource Capital Corp. Shareholder Derivative Litigation, Master Index No. 654485/2015; and it is further

ORDERED that the pleadings in the actions hereby consolidated shall stand as the pleadings in the consolidated action; and it is further

ORDERED that movants are directed to serve a copy of this order with notice

of entry on the County Clerk (Room 141 B), who shall consolidate the papers in the actions hereby consolidated and shall mark his records to reflect the consolidation; and it is further

ORDERED that movants are directed to serve a copy of this order with notice of entry on the Clerk of the Trial Support Office (Room 158), who is hereby directed to mark the court's records to reflect the consolidation.

The foregoing constitutes the decision and order of the court.

Date: June 7, 2017
New York, New York

Anil C. Singh