

**MMA Meadows at Green Tree, LLC v Millrun Apts.,
LLC**

2018 NY Slip Op 30647(U)

March 28, 2018

Supreme Court, New York County

Docket Number: 653943/2013

Judge: Shirley Werner Kornreich

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SUPREME COURT OF THE STATE OF NEW YORK
NEW YORK COUNTY

PRESENT: HON. SHIRLEY WERNER KORNREICH

PART 54

Justice

MMA MEADOWS AT GREEN TREE, LLC, BFIM SPECIAL LIMITED PARTNER, INC., DERIVATIVELY ON BEHALF OF, MCAP ROBESON APARTMENTS L.P., MMA MEADOWS AT GREEN TREE, LLC IN ITS INDIVIDUAL CAPACITY,

INDEX NO. 653943/2013

MOTION DATE 4/28/17

MOTION SEQ. NO. 009/010/011

Plaintiff,

- v -

MILLRUN APARTMENTS, LLC, MUNICIPAL CAPITAL APPRECIATION PARTNERS II, L.P., MUNICIPAL CAPITAL APPRECIATION PARTNERS III, L.P., RICHARD COREY, MCAP II DEVELOPER LLC, MCAP ROBESON APARTMENTS L.P., NOMINAL PARTY,

DECISION AND ORDER

Defendant.

The following e-filed documents, listed by NYSCEF document number (Motion 009) 212-222, 277-290, 291-296, 325-338

were read on this motion to/for PARTIAL SUMMARY JUDGMENT

The following e-filed documents, listed by NYSCEF document number (Motion 010) 224-261, 274-276, 298-303, 323

were read on this motion to/for SUMMARY JUDGMENT(AFTER JOINDER

The following e-filed documents, listed by NYSCEF document number (Motion 011) 263-273, 274-276

were read on this motion to/for SUMMARY JUDGMENT(AFTER JOINDER

Upon the foregoing documents, it is ordered that motion sequence number 009 is decided in accordance with the accompanying memorandum decision and order; and it is further

Ordered that motion sequence numbers 010 and 011 are decided in accordance with the decision and order on motion sequence number 009.

Handwritten signature and date 3/28/18

Handwritten signature of Shirley Werner Kornreich

SHIRLEY WERNER KORNREICH, J.S.C. SHIRLEY WERNER KORNREICH

Form with checkboxes for CASE DISPOSED, GRANTED, DENIED, NON-FINAL DISPOSITION, GRANTED IN PART, SUBMIT ORDER, FIDUCIARY APPOINTMENT, OTHER, REFERENCE.

Handwritten note: 3 cross-motions

SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK: PART 54

-----X
MMA MEADOWS AT GREEN TREE, LLC, and
BFIM SPECIAL LIMITED PARTNER, INC.,
Derivatively on Behalf of MCAP ROBESON
APARTMENTS L.P., and MMA MEADOWS AT
GREEN TREE, LLC in its Individual Capacity,

Index No.: 653943/2013

DECISION & ORDER

Plaintiffs,

-against-

MILLRUN APARTMENTS, LLC, MUNICIPAL
CAPITAL APPRECIATION PARTNERS II, L.P.,
MUNICIPAL CAPITAL APPRECIATION
PARTNERS III, L.P., RICHARD G. COREY, and
MCAP II DEVELOPER LLC,

Defendants,

-and-

MCAP ROBERSON APARTMENTS L.P.,

Nominal Party.

-----X
SHIRLEY WERNER KORNREICH, J.:

Motion sequence numbers 009, 010, 011 are consolidated for disposition.

Plaintiffs MMA Meadows at Green Tree, LLC (ILP) and BFIM Special Limited Partner, Inc.¹ (SLP) (with ILP, Limited Partners), derivatively on behalf of MCAP Robeson Apartments, L.P. (Partnership), and ILP in its individual capacity move for partial summary judgment pursuant to CPLR 3212 on causes of action: III and XII for breach of contract against Millrun Apartments, LLC (Millrun GP); X for fraud against Municipal Capital Appreciation Partners II, L.P. (MCAP II) and Richard G. Corey; XI for breach of contract against MCAP II; IV for breach

¹ F/k/a MMA Special Limited Partner, Inc.

of contract against Municipal Capital Appreciation Partners III, L.P. (MCAP III); and VIII and XIII for indemnification against MCAP II. Seq. 009. Defendants oppose.

Defendants Millrun GP, MCAP II, and Corey (collectively, the GP Defendants) move for summary judgment pursuant to CPLR 3212 on all claims against them. Seq. 010. Defendant MCAP III moves for summary judgment pursuant to CPLR 3212 on cause of action IV for breach of contract. Seq. 011. Plaintiffs oppose both motions. For the reasons discussed below, plaintiffs' motion is granted-in-part and denied-in-part, the GP Defendants' motion is granted in part and denied in part, and MCAP III's motion is denied.

I. Procedural History & Factual Background

Familiarity with the court's prior decision (the November 26, 2014 motion to dismiss [Dkt. 103] [MTD Order])² and the Appellate Division, First Department, modification (*MMA Meadows at Green Tree, LLC v Millrun Apartments, LLC*, 130 AD3d 529 [1st Dept. 2015]) is presumed.³ Moreover, the parties have submitted a joint statement of undisputed facts (JS) (Dkt. 182). The facts discussed below are uncontested unless otherwise noted.

Plaintiffs and Millrun GP are parties to an agreement dated June 13, 2006 (the Partnership Agreement), which governs a Delaware limited partnership (the Partnership) that owns an affordable housing project in Clarksville, Indiana (the Project). JS ¶¶ 1-2, 4. The Partnership Agreement is governed by Indiana law. Dkt. 183 (Partnership Agreement) at 18, 73. Millrun GP is the general partner. JS ¶ 3. MCAP II, a private equity fund, is the managing

² References to "Dkt." followed by a number refer to documents filed in this action on the New York State Courts Electronic Filing system (NYSCEF). Page numbers refer to the e-filed PDF.

³ Motions for summary judgment in a related case before this court, *Walnut Housing Assocs. 2003 L.P. v MCAP Walnut Housing LLC*, Index No. 653945/2013 (*Walnut*), have been decided in a separate memorandum decision and order.

member of Millrun GP. JS ¶ 7. MCAP III is a private equity fund which, together with MCAP II, holds bonds issued to fund the Project. Corey controls defendants Millrun GP, MCAP II, and MCAP III. *See* Dkt. 83 at 2 (11/12/2009 letter from Corey to Mike Gladstone at BFIM); Dkt. 261 (GP Defs.’ Opening Br.) at 10. Additionally, the Project’s property manager, Equity Management, Inc. (Equity),⁴ acts at the direction of Corey’s employer, Zephyr Management, L.P. (Zephyr). Dkt. 215 [Early Exs.] at 494 (Potvin Dep. 33:2-13, 34:5-19); JS ¶ 27. Zephyr also provides management services to MCAP III. JS ¶ 27.

ILP is the investor limited partner, and SLP is the special limited partner in the Partnership; both Limited Partners are controlled by Boston Financial Investment Management (BFIM).⁵ JS ¶¶ 3-6. ILP made capital contributions of nearly \$5.3 million to the Partnership (JS ¶ 80), and the Partnership received \$5.3 million in tax credits, the major incentive for ILP’s investment. JS ¶ 10. Of those tax credits, 99.99% are allocable to ILP, in accordance with its equity interest in the Partnership. Dkt. 183 (Partnership Agreement) at 3, 25-27, 62, 80. Some of the tax credits remain subject to forfeiture under federal tax law if the Project ceases to provide or reduces the number of low income housing units.

Under § 6.4(G) of the Partnership Agreement, Millrun GP had “fiduciary responsibility for the safekeeping and use of all funds and assets of the Partnership” and was prohibited from “employ[ing], or permit[ing] another to employ, such funds or assets in any manner except for the exclusive benefit of the Partnership.” Dkt. 183 (Partnership Agreement) at 36. Moreover,

⁴ Equity’s corporate representative testified that in July 2008, newly formed Equity Management II, LLC, purchased the management contract relating to the Project. Dkt. 215 [Early Exs.] at 491 (Potvin Dep. 23:17-24:3). This opinion refers to both entities as Equity.

⁵ ILP and SLP were previously controlled by MMA Financial, Inc. (MMA), a plaintiff-related entity. This opinion refers to both BFIM and MMA as BFIM.

under § 6.4(H), “[n]o General Partner shall contract away the fiduciary duty owed at common law to the Limited Partners.” *Id.* at 36.

Under § 6.5 of the Partnership Agreement, Millrun GP made dozens of continuing representations and warranties to ILP. Dkt. 183 (Partnership Agreement) at 38-42. For example, § 6.5(ii) warrants that there is no pending litigation directly affecting the Project or that could adversely affect the Partnership. *Id.* at 38. Section 6.5(iii) warrants that no default by Millrun GP, its affiliates with a relationship to the Project, or the Partnership has occurred or is continuing under certain Project-related documents. *Id.* Section 6.5(xi) warrants that “[n]o General Partner is in default in any material respect in the observance or performance of any provision of this Agreement to be observed or performed by such General Partner.” *Id.* at 40. Section 6.5(xii) warrants that certain Partnership-related agreements are in full force and effect, and that no party thereto (apart from ILP and its affiliates) has defaulted on those agreements. *Id.* Section 6.5(xix) warrants that there are no pending suits against Millrun GP and its affiliates. *Id.* at 41.

In order to “induce the Investor Limited Partner to acquire an interest in the Partnership,” MCAP II “unconditionally[] guarantee[d] to the Investor Limited Partner, ... the due and punctual performance by the General Partner under the Partnership Agreement.” Dkt. 184 (Guaranty) at 2; JS ¶ 11. MCAP II agreed to maintain an aggregate net worth of at least \$5 million and liquid assets of at least \$1 million and to furnish the Investor Limited Partner with an accurate, current financial statement demonstrating this within 90 days of the close of each fiscal year or at the Limited Partner’s reasonable request. Dkt. 184 (Guaranty) at 2. The Guaranty further provides:

The Guarantor hereby agrees that its obligations hereunder shall be unconditional (and shall not be subject to any advance, set-off, counterclaim or recoupment whatsoever), irrespective of the

regularity or enforcement of any Project Document, the Partnership Agreement, the Development Agreement or this Agreement or any other circumstances which might otherwise constitute a legal or equitable discharge of a surety or guarantor or any other circumstances which might otherwise limit the recourse of the Investor Limited Partner against the undersigned. The undersigned hereby waives diligence, presentment and demand for payment, protest, any notice of any assignment hereunder in whole or in part or of any default hereunder or under any Project Document, the Partnership Agreement or the Development Agreement, and all notices with respect to this Guaranty, the Partnership Agreement, the Development Agreement or the Project Documents. No waiver by the Investor Limited Partner of any of its rights under the Project Documents, the Partnership Agreement, the Development Agreement or this Guaranty and no action by the Investor Limited Partner to enforce any of its rights under this Guaranty or failure to take, or delay in taking, any such action shall effect the Guarantor's obligations hereunder.

Id. at 2-3. MCAP II's obligations, however, are "subject to the Investor Limited Partner not being in material default of its obligations under the Partnership Agreement." Dkt. 184 at 4.

MCAP II's obligations under the Guaranty include Millrun GP's obligation to advance funds—capped at \$816,000—toward any Partnership operating expense deficit (the Operating Deficit Guaranty) under § 6.9 of the Partnership Agreement, which states, *inter alia*:⁶

[I]f the Partnership ***requires funds to discharge Operating Expenses*** (other than to make payments to Partners, payments of any outstanding Operating Expense Loans or other obligations herein provided to be payable solely out of Cash Flow or distributions of proceeds from a Capital Transaction), ***the General Partners shall furnish to the Partnership the funds required. ...*** Amounts furnished to fund Operating Expenses ... shall constitute Operating Expense Loans. Notwithstanding the foregoing, however, the ***General Partners shall not be obligated*** to make Operating Expense Loans under this Section 6.9 ***to the extent that the***

⁶ The requirements of § 6.9 (and the definition of "Operating Expenses," excerpted herein) vary based on whether the "Development Date" has elapsed. For example, § 6.9 states that the obligation to advance operating expenses is ***unlimited*** prior to the Development Date. As the parties agree that Millrun GP's obligation to advance operating expenses was capped at \$816,000, the court assumes that the Development Date elapsed prior to 2009.

outstanding aggregate principal amount of such Operating Expense Loans (excluding Operating Expense Loans made pursuant to Section 6.12B) *would exceed \$816,000.*

Dkt. 183 at 45 (emphasis added). “Operating Expenses” comprise

all the costs and expenses of any type incurred incidental to the ownership and operation of the Project, including, without limitation, taxes, *capital improvements reasonably deemed necessary by the General Partners and not funded out of any reserves for such*, mortgage and bond insurance premiums, if any, and the cost of operations, debt service, maintenance and repairs, *and the funding of any reserves required to be maintained by any Lender or Governmental Agency or pursuant to this Agreement*, but *shall not include* (i) repayments of Operating Expense Loans made pursuant to Section 6.9 or (ii) *distributions or payments to Partners pursuant to Article X.*

Id. at 14 (emphasis added).

To promote affordable housing, the Town of Clarksville, Indiana (the Town) entered a loan and financing agreement with the Partnership, dated November 1, 2007. Dkt. 186 (Loan Agreement) at 6. The Town issued \$6.5 million in Series A Bonds and \$2 million in Series B Bonds (collectively Bonds), now held by MCAP III and MCAP II (collectively Bondholders), respectively, to fund the loan. JS ¶¶ 16-18. It also entered an indenture agreement dated November 1, 2007, with Bank of New York Trust Company, N.A. (BONY)⁷ as Trustee on behalf of the Bondholders, assigning the Town’s rights under the Loan Agreement to the Trustee for the Bondholders’ benefit. JS ¶¶ 19-20; Dkt. 185 (Indenture) at 7-9. The Series A debt was secured by a senior mortgage lien on the Project, and the Series B debt was secured by a junior mortgage lien. Dkt. 186 (Loan Agreement) at 84-85. The Series B Bonds were “subordinated in priority

⁷ Bank of New York Mellon Trust Company, N.A. was successor-in-interest to Bank of New York Trust Company, N.A. under the Indenture. Dkt. 335 [Berning Aff.] ¶ 3. Both are referred to as BONY herein. The current trustee is Wells Fargo Bank N.A. (Wells Fargo). JS ¶ 21.

and in right and time of payment” to the Series A Bonds. Dkt. 185 (Trust Indenture) at 30. The Indenture stipulates that “*no default shall exist with respect to the Series B Bonds or the Series B Note until the date no Series A Bonds are Outstanding.*” *Id.* at 31 (emphasis added).

Section 10.1(b) of the Loan Agreement defines “Events of Default” to include, *inter alia*, when “[t]he Borrower fails to pay, on the date on which the same is due and payable[,] the principal of, premium (if any) or interest or any other charges or sums on or under the Note.”⁸ Dkt. 186 (Loan Agreement) at 44. No cure period is specified. Section 8.1(b) of the Indenture defines “Events of Default” to include, *inter alia*, “[t]he occurrence of an ‘Event of Default’ as defined in Section 10.1 of the [Loan Agreement] that continues beyond the applicable cure period provided therein, *if any.*” Dkt. 185 (Indenture) at 41-42 (emphasis added). Section 10.2 of the Loan Agreement and Section 8.2 of the Indenture specify remedies on default, such as acceleration and foreclosure, that the Trustee *must* take at the direction of MCAP III (as Servicing Agent). Dkt. 186 (Loan Agreement) at 47-49; Dkt. 185 (Indenture) at 42.

The Indenture also permits MCAP III to restore the parties after default:

SECTION 8.2. Remedies on Default. ... (b) At any time after a declaration of acceleration has been made, [MCAP III] *may* ... rescind and annul such declaration and its consequences and *the parties shall be restored to the same position as before the occurrence of such Event of Default* if: ...

(ii) *there has been paid to or deposited with the Trustee for the account of the Issuer, or provision for such payments has been made in a manner satisfactory to [MCAP III]:*

(A) all accrued installments of *interest* on the Bonds and any *late charges or penalties* due pursuant to Section 3.1 hereof,

⁸ The term “Note” in the Loan Agreement refers to both the “Series A Note” (Dkt. 58) and “Series B Note” (not made of record) issued by the Partnership to the Town. Each corresponds to the amount payable on the respective Bond. Dkt. 186 (Loan Agreement) at 77, 84-85.

(B) the principal of and premium, if any, on the Bonds which have become due otherwise than by such declaration of acceleration and interest thereon as provided in this Indenture, and

(C) all sums paid or advanced by the Holders, the Trustee or the Issuer hereunder and the reasonable compensation, expenses, disbursements and advances of the Holders, the Trustee and the Issuer, their agents and counsel up to the date of the written notice.

Dkt. 185 (Indenture) at 42-43 (emphasis added).

In a separate agreement with MCAP III and BONY (as Trustee) also dated November 1, 2007, the Partnership agreed to make monthly deposits of \$3,400 into a repairs and capital improvements fund (the Replacement Reserve). Dkt. 282 (Reserve Agreement) at 2. The Reserve Agreement granted the Trustee a security interest in the Replacement Reserve funds as security in the event of a default in the Partnership's performance of its obligations under the Loan Agreement. *Id.* at 3. It also required MCAP III to authorize Replacement Reserve disbursements for, among other things, code compliance and repair or restoration of the Project after a casualty. *Id.* at 3-4. Section 6.12(A) of the earlier-executed Partnership Agreement required Millrun GP to establish a "reserve account for capital replacements" (the § 6.12(A) Reserve) "utilized solely to fund capital repairs and improvements deemed necessary by the General Partners" and funded by monthly deposits of \$4,250. Dkt. 183 (Partnership Agreement) at 46.

By mid-2008, ILP had made two of the three mandatory capital contributions to the Partnership. The third (the Third Installment) was contingent on the Partnership achieving a Debt Service Coverage Ratio (DSCR) of 111% or higher for each of three consecutive months. Dkt. 185 (Partnership Agreement) at 24. The Partnership Agreement defines the DSCR as follows:

for any specified period of consecutive calendar months beginning not earlier than three (3) months prior to the Bond Funding Date, a fraction, the *numerator* of which is the *Cash Available for Debt Service Requirements* with respect to such period and the *denominator* of which is the *Debt Service Requirements* for such period. The achievement by the Partnership of a specified Debt Service Coverage Ratio *shall be confirmed by the Accountants and shall be subject to independent confirmation by the Investor Limited Partner* pursuant to a physical inspection of the Property for the purpose of confirming that the Property is in good condition and repair (ordinary wear and tear excepted) ...

Dkt. 183 (Partnership Agreement) at 7 (emphasis added). The Partnership Agreement defines

“Cash Available for Debt Service Requirements” (the DSCR numerator) as follows:

for any specified period of consecutive months beginning not earlier than three (3) months prior to the Bond Funding Date, the excess of (i) all Cash Receipts during such period over (ii) *all cash requirements of the Partnership properly allocable to such period of time on an accrual basis* (not including payments of the Permanent Loan or distributions or fees to Partners payable solely out of Cash Flow of the Partnership) *and, on an annualized basis, all projected expenditures*, including those of a seasonal nature which might reasonably be expected to be incurred on an unequal basis during a full annual period of operation, *as determined by the Accountants but specifically excluding Debt Service Requirements*. For purposes of this definition, (i) *cash requirements of the Partnership shall include to the extent not otherwise covered above, full funding of reserves, normal repairs and necessary capital improvements* ...

Id. at 6 (emphasis added). “Cash Receipts” are defined as

with respect to a Fiscal Year or other applicable period, *all rental revenue, laundry income, parking revenue*, and other *incidental revenues* which are received by the Partnership *on a cash basis* during such period and arise *from normal operations* of the Project, *plus any subsidy payments* received by the Partnership *on an accrual basis*, but specifically excluding interest on Partnership reserves, proceeds from insurance (other than business or rental interruption insurance), loans, proceeds of a Capital Transaction or Capital Contributions. In addition, *any amount released without restriction from any escrow account* in a Fiscal Year shall be considered a *cash receipt* of the Partnership *for such Fiscal Year*.

Id. (emphasis added). “Debt Service Requirements” (the DSCR denominator) are defined as

for any specified period of consecutive calendar months ..., ***all currently required debt service, mortgage insurance premium and/or other cash requirements imposed by the Mortgage Loan Documents*** (including without limitation recurring fees associated with the Bonds or any credit enhancement relating thereto) or any other indebtedness (other than the Permanent Loan) properly allocable to such period of time ***on an annualized accrual basis as determined by the Accountants.***

Id. at 8 (emphasis added). “Mortgage Loan Documents” means “the loan agreements, Notes, Mortgages and ***other documents evidencing and securing any Mortgage Loan*** (including, without limitation, the Bond Documents) ***or otherwise entered into connection therewith.***” *Id.* at 14 (emphasis added). Payment on the B Bonds (held by MCAP II) depended upon the same DSCR test. *See* Dkt. 277 (GP Defs.’ Opp. Br.) at 16; Dkt. 291 (Pls.’ Reply Br.) at 16.

In July 2008, Zephyr requested that ILP waive the DSCR test. Dkt. 328 (Johnson 10/26/2015 Dep.) 87:21-88:5; Dkt. 215 [Early Exs.] at 611 (7/25/2008 Corey email to Voyentzie at BFIM). ILP refused. Upon an October 2008 investor inquiry regarding projected distribution through April 2009, Zephyr employees discussed the fact that cash distributions from MCAP II were contingent on payment of the Third Installment. Dkt. 331 (10/31/2008 email from Johnson to Megna) at 2; Dkt. 326 (Corey 10/20/2015 Dep.) 235:6-236:17. After failing the test in August, September and October 2008, Zephyr told Equity, the property manager, that Zephyr sought to pass the test for November 2008 through January 2009. Dkt. 215 [Early Exs.] at 634-36 (11/14/2008 Johnson email to Loretta Gaegler at Equity).

In early November 2008, Equity apprised Zephyr of new federal safety requirements (Pub. L. No. 110-140, 121 Stat. 1492) mandating installation of a dual drain at the bottom of the Project’s pool at a projected cost of \$23,000. Dkt. 215 [Early Exs.] at 618-19 (11/3/2008 email from Bill Geoffrion at Equity to Charles Frischer at Zephyr); *id.* at 624-25 (11/5/2008 Geoffrion

email to Frischer). Equity informed Zephyr that federal law as of December 12, 2008, prohibited operation⁹ of a noncompliant pool. *Id.* at 624-25 (11/5/2008 Geoffrion email to Frischer). Zephyr agreed they “might just have to do the work,” but requested that Equity delay any work or expenditures until after the three-month test period. *Id.* at 618 (11/4/2008 Frischer emails to Geoffrion); *see also id.* at 621 (Corey email to Geoffrion and Frischer) (conveying preference to wait to complete and book the expense until 2009). In one email, Corey even refused to incur a \$3,000 deposit in 2008 to ensure timely completion of the work. *Id.* at 631-32 (11/11/2008 Corey email to Geoffrion).¹⁰

Also in November 2008, Equity informed Zephyr that an insurance adjuster had assessed the Project for \$37,000 in wind damage (including to the Project roof), that the insurance policy bore a \$25,000 deductible, and that the repairs would be completed within the test period. Dkt. 215 [Early Exs.] at 627-29 (11/7/2008 email from John Potvin at Equity to Johnson). At Corey’s and Zephyr’s direction, Equity carried an approximate \$33,000 expense for the repairs on its books during the “test out period”, until late February 2009.¹¹ Dkt. 215 [Early Exs.] at 941

⁹ *See* 15 USC § 8003(c)(2)(B) (defining “Public pool and spa” as a swimming pool “*open* exclusively to ... (ii) residents of a multi-unit apartment building, apartment complex, residential real estate development, or other multi-family residential area ...” (emphasis added)).

¹⁰ After requesting Zephyr’s permission in March 2009, *following the test period*, Equity had the pool work performed at a total cost of \$23,800. Dkt. 215 [Early Exs.] at 1028 (March 2009 Project financial statements); *id.* at 1199 (Ex. 46, April 2009 Project financial statements); *id.* at 955 (3/11/2009 email from Loretta Gagler at Equity to Johnson). These financial statements produced by the Partnership state that *two* \$11,900 payments were made, a “deposit” to American Leak Detection in March 2009 and “final pymt” in April 2009. Defendants argue that only “\$12k was spent on Pool Improvements” based on an April 21, 2009 email to Johnson at Zephyr (*id.* at 1117), but proffer no explanation as to why the Partnership’s financial statements state otherwise.

¹¹ Defendants admit that the wind damage repairs were performed or invoiced between November 2008 and January 2009. Dkt. 277 (GP Defs.’ Opp. Br) at 20. The Partnership’s January 2009 financial statement reflected an “Insurance Loss” debit of \$25,332.08 on January 7,

(2/11/2009 emails between Potvin and Corey); *id.* at 953 (2/25/2009 emails between Potvin and Corey).¹²

On December 11, 2008, BFIM requested the 2009 annual Partnership budget. Dkt. 215 [Early Exs.] at 642 (email to Charles Frischer at Zephyr). On December 15, 2008, Johnson sent a draft of the 2009 budget to his Zephyr colleague to review, asking him to “see how it compares to our DSCR test.” Dkt. 215 [Early Exs.] at 669 (12/15/2008 Johnson email to Mathew Samuel). This draft had allotted \$24,000 to “Pool Improvements”, at a cost of \$2,000 per month. Dkt. 215 [Early Exs.] at 673 (Draft Meadows at Green Tree 2009 Budget at 3). On December 23, 2008, Zephyr sent ILP a revised budget allocating only \$83 a month for “pool improvements”, or \$1,000 annual total, and \$3,431 each month for capital improvements, purportedly “funded by” the monthly \$3,400 “Replacement Reserve Useable”. Dkt. 215 [Early Exs.] at 753 (12/23/2008 Samuel email to ILP); *Id.* at 759 (Project 2009 Budget). Zero dollars were allotted to exterior improvements or roof replacements in 2009. *Id.* In a later email to Corey, Equity described that the Partnership had failed to budget for the pool improvements and insurance loss. *See id.* at 1117 (4/21/2009 email from Remillard at Equity to Corey).

Zephyr retained Reznick Group, P.C. (Reznick) to calculate the DSCR. Reznick prepared an agreed-upon procedures report (the AUP Report) dated January 31, 2009, which referenced

2009, and a corresponding credit two days later in the same amount. Dkt. 215 [Early Exs.] at 937. Plaintiffs allege that this reflected a repayment of the insurance deductible to Equity and a subsequent reversal of that transaction. Defendants provide no competing explanation for this financial record.

¹² This correspondence also references bills held since December for Gordon Campbell (the Campbell Invoices). Dkt. 215 [Early Exs.] at 953 (2/25/2009 emails between Potvin and Corey); *see also id.* at 506 (Potvin Dep. 81:20-82:14) (admitting that Equity believed “[t]he property did not have enough money to pay the bills” in December). On March 2, 2009, the Partnership paid \$3,920.29 Campbell & Associates on two invoices dated October 31, 2008. Dkt. 215 [Early Exs.] at 1027 (Project financial statement dated March 31, 2009).

“the Partnership Agreement, the internal operating statements, the annual budget and the general ledger for each of the three months ended January 31, 2009.” Dkt. 215 [Early Exs.] at 946-51. Attaching a schedule of unadjusted and adjusted revenue and expenses for each month in the test period (the Schedule) for which “management ha[d] taken full responsibility,” the AUP Report stated that Reznick “w[as] not engaged to and did not perform an examination, the objective of which would be the expression of an opinion on the Schedule referred to herein.” *Id.* at 947-48 (AUP Report); *id.* at 949-51 (the Schedule). Reznick reported that it had “adjusted the Schedule to annualize all expenditures” based on “correspondence with management.” *Id.* at 947.

Pursuant to Zephyr’s instructions and assurances that capital expenditures were “expected to be repaid” by the monthly \$3,400 Replacement Reserve deposits, Reznick excluded capital expenditures from the calculation. Dkt. 215 [Early Exs.] at 352 (Ryan Henigan Dep. 137:17-138:2); *id.* at 947 (AUP Report) (“Adjustments were made based on management’s explanations ... [t]o remove capital improvements expenses, as all costs are expected to be repaid out of the Reserve for Replacements.”). For example, \$1,966 of capital expenses were added and subtracted for November 2008. *Id.* at 951 & n.4 (AUP Report). Zero dollars in pool improvements were reported for all three months. *Id.* at 951; *id.* at 338 (Henigan Dep. 114:2-12).

Reznick included the monthly Replacement Reserve deposits as a Debt Service Requirement (i.e., in the denominator) of the DSCR. *Id.* at 947 (AUP Report) (“Management’s understanding of Debt Service Requirements is the required monthly principal and interest payments on the Series A bonds and the monthly replacement reserve deposits.”). Reznick’s corporate representative explained that including reserve-covered capital expenses under Cash Available for Debt Service Requirements (the DSCR numerator), in addition to including the \$3,400 monthly Replacement Reserve requirement in the denominator, would result in a

“duplication of cost.” Dkt. 215 [Early Exs.] at 333 (Henigan Dep. 62:22-63:9).¹³ Further, Reznick’s corporate representative testified, and defendants do not dispute, that Zephyr never disclosed the pool repair estimate to Reznick. Dkt. 215 [Early Exs.] at 345 (Henigan Dep. 109:21-110:13).

On February 20, 2009, Corey certified on behalf of MCAP II and Millrun GP that “[t]he Partnership has achieved a Debt Service Coverage Ratio of 111% for each of three (3) consecutive months,” attaching the AUP Report as evidence of the achievement. Dkt. 215 [Early Exs.] at 943-44 (Certificate). After receiving the Certificate, ILP paid the Third Installment, \$1,150,434, in approximately March 2009. JS ¶ 9.

Pursuant to the Partnership Agreement (Dkt. 183 at 46), \$208,000 of the Third Installment proceeds funded an Operating Reserve. Dkt. 248 (12/31/2009 Partnership audited annual financial statement) at 13-14. The Partnership Agreement specifies that “[f]unds in the Operating Reserve may be used to pay Operating Expenses, to the extent required, subject to any Requisite Approvals and to the Consent of the Investor Limited Partner.” Dkt. 183 (Partnership Agreement) at 46. “Consent of the Investor Limited Partner” means “prior written consent or approval of the Investor Limited Partner, ... such consent not to be unreasonably withheld or delayed.” Dkt. 183 (Partnership Agreement) at 7. Remaining proceeds of \$941,968 went toward

¹³ Reznick’s corporate representative also explained that Reznick did not analyze whether the reserve had sufficient funds to cover capital expenditures. Dkt. 215 [Early Exs.] at 349 (Henigan Dep. 125:1-126:10). As of December 2008, Equity projected \$214,055 in Partnership capital expenses in that year. *Id.* at 756 (2009 Budget sent to MMA). Equity later recorded \$218,438 in actual capital expenditures in 2008. *Id.* at 1120 (net operating income spreadsheet for the Project attached to 4/21/2009 email from Jason Remillard at Equity to Corey). Annually, only \$40,800 were deposited in the Replacement Reserve. The Partnership’s 2008 audited financial statement indicated that \$44,630 remained in the Replacement Reserve. Dkt. 249 at 4.

repayment of a Deferred Development Fee Note dated June 13, 2006 (Dkt. 258) held by (MCAP II-controlled) MCAP II Developer LLC. *See* Dkt. 257 (3/3/2009 email from Johnson to Sutton).

In April 2009, the Trustee invoiced the Partnership for debt service on the Bonds, including \$249,755.04 in deferred interest on the B Bonds, which were subordinate to the A Bonds and payment of which required the Partnership to pass the DSCR test. Dkt. 328 at 62 (10/26/2015 Johnson Dep. 237:13-19). B Bond interest had accrued since December 1, 2007. Zephyr instructed Equity to include the B Bond interest in “accounts payable”, at which point Millrun GP would “advanc[e] the operating deficit per [the] partnership agreement.” Dkt. 215 [Early Exs.] at 1114 (4/10/2009 Johnson email to Potvin). On April 24, 2009, MCAP II advanced \$250,000 “[t]o record operating deficit funding” for the Partnership. *Id.* at 1295 (6/19/2009 Partnership Operating Deficit Guaranty Balance). On May 1, 2009, the Partnership paid \$249,755.04 in accrued interest on the B Bonds and another \$13,333 in interest on June 1, 2009. *See* Dkt. 328 at 62 (Johnson 10/26/15 Tr.) 237:13-238:16; Dkt. 334 (Nelson Expert Rpt.) at 32 ¶ 11; JS ¶ 23. By mid-June 2009, the GP Defendants calculated that the \$816,000 Operating Deficit Guaranty had been exhausted as of May 27, 2009. Dkt. 215 [Early Exs.] at 1295 (6/19/2009 Partnership Operating Deficit Guaranty Balance).

On June 19, 2009, eleven days before the Series A Bonds debt service deadline, Equity informed Corey that the Partnership had \$26,680 in cash on hand and accounts payable of \$144,087. Dkt. 239 (email from Louis Sigalas at Equity to Corey). Forwarding Equity’s email to ILP, Corey stated that the Operating Deficit Guaranty had been “fully funded” and requested that ILP release \$118,000 from the Operating Reserve. *Id.* (6/19/2009 Corey email to Brandon Sutton). A week later, through counsel, Zephyr told ILP that a draw upon reserves was necessary to pay debt service on the A Bonds on or before July 1 to “avoid a monetary default and waste.”

Dkt. 240 (6/26/2009 letter from Joseph Donley to Matthew Oakey). On June 29, 2009, BFIM asset manager Brandon Sutton told Corey and Johnson that ILP would not consent to the Operating Reserve draw because Zephyr had known of structural issues at the Project in December 2008, and the Third Installment should have been held back for estimated costs rather than paid to MCAP II Developer LLC since the Developer Fee was not due until all construction costs had been paid. Dkt. 241 (Sutton email to Corey and Johnson) at 1. On July 1, Corey responded with an attorney letter dated June 30, 2009. Dkt. 275 [Maroney Exs.] at 103-05 (Corey email to Sutton attaching opinion letter).¹⁴

Discussions between Corey and Sutton regarding the Operating Reserve continued into the Wednesday, July 1 deadline. *Id.* at 100 (Corey email to Sutton). CC'ing his BFIM colleague, Greg Voyentzie, Sutton asked if the matter could wait until Monday after the July 4th holiday weekend, as Sutton's wife was in labor. *Id.* at 110 (Sutton email to Corey). Sutton further advised that "[t]he fund manager who needs to give final approval once I ok is out until then anyway." *Id.* Corey responded to Sutton, "I cannot imagine that you should do anything but be with your wife. If you want us to follow up with [sic] someone else, please let [sic] know." *Id.* (Corey email to Sutton). Corey sent Voyentzie a separate email, advising "I can't think of any reason you would want to get involved," to which Voyentzie agreed. *Id.* at 107 (emails between Corey and Voyentzie). At the same time, Corey emailed the trustee (then BONY) to notify it of the anticipated default on the Series A Bonds:

[W]e were advised by the Investor that no manager is available to review our prior requests for release of operating reserve funds until next week. Therefore, absent something changing, you will not be

¹⁴ The letter did not dispute that "the need for the foundation work was established before the payment of the final equity installment on March 13, 2009," but claimed that the foundation work fell outside the scope of the original construction. Dkt. 275 [Maroney Exs.] at 103-05.

receiving a wire or check until at least next week. I will reconfirm after close of business. The Sole Bondholder will be also informed and will likely contact you first thing tomorrow. Your diligence is appreciated.

Id. at 113 (7/1/2009 Corey email). Series A debt service was not paid on the deadline. JS ¶ 24.

The next day, Thursday, July 2, Corey (on behalf of MCAP III) instructed BONY to notify the Partnership (Corey himself) of the Series A bonds default, charge default interest, accelerate the debt, and institute foreclosure proceedings. Dkt. 215 [Early Exs.] at 1298-303. On Friday, July 3, BONY notified the Partnership (again, Corey) of the default and accelerated the debt on the Series A Note. JS ¶¶ 25-26; Dkt. 187 at 2-3 & Dkt. 188 at 2-3 (the Notices).

On Monday, July 6, 2009, Sutton contacted Corey as promised to request additional information regarding release of Operating Reserve funds. Dkt. 275 [Maroney Exs.] at 120 (7/6/2009 Sutton email to Corey). Corey reminded Sutton that “debt service was not paid July 1 and is in default.” *Id.* at 119 (7/6/2009 Sutton email to Corey). When Sutton stated that “[s]ince an affiliated MCAP entity holds the debt, I’ll assume we are not at risk of foreclosure at this time,” Corey swiftly disabused Sutton of that assumption. *Id.* at 119 (7/6/2009 Corey email to Sutton) (“Incorrect, particularly when there us [sic] money sitting in reserves and MMA defaulted on their obligation to buy Series A Bonds.”).¹⁵

ILP received the Notices on July 13, 2009. *Id.* at 116 (email from Parks at MMA Financial, Inc. to Sutton). On July 20, 2009, ILP consented to release Operating Reserve funds to pay July and August debt service on the A Bonds. JS ¶¶ 28-29; Dkt. 275 [Maroney Exs.] at 131

¹⁵ Corey’s email referred to BFIM predecessor’s refusal to purchase \$9.5 million in Series A bonds, which left the Bondholders to restructure and purchase the bulk of the Partnership’s debt. Defendants blame the Partnership’s economic woes on this refusal, but fail to substantiate their claim that it excused defendants’ behavior. Dkt. 261 (GP Defs.’ Opening Br.) at 10.

(Sutton email to Corey). Corey calculated principal and default interest and directed BONY to make payments on the Series A bonds accordingly. Dkt. 215 [Early Exs.] at 1317 (7/31/2009 Corey email to BONY). Corey stated that MCAP III would nonetheless refuse to waive the default interest. Dkt. 275 [Maroney Exs.] at 131 (7/20/2009 Corey email to Sutton). When BONY failed to invoice for default interest in August 2009 (Dkt. 335 [Berning Aff.] ¶¶ 9-10; *id.* at 15 [8/3/2009 email from Faith Berning at BONY to Robert Major at BONY]), Corey replaced BONY with Wells Fargo.¹⁶

In November 2009, Wells Fargo filed a foreclosure suit against the Partnership in Indiana Superior Court (Foreclosure Action) at MCAP III's (Corey's) direction. JS ¶ 30; Dkt. 189 (11/18/2009 Foreclosure Action complaint). Corey, who controlled the Partnership's general partner (through its managing member), told ILP that Millrun GP would assert no defenses, and tendered the defense of the Foreclosure Action to ILP. Dkt. 245 (11/12/2009 Corey letter to Michael Gladstone at BFIM). ILP refused the tender, insisting that Corey had a fiduciary duty to defend the action. Dkt. 216 [Gladstone Exs.] at 9-10 (11/23/2009 Gladstone letter to Corey).¹⁷ The answer filed January 20, 2010 (Dkt. 190) asserted no defenses and admitted the default. JS ¶¶ 32-33. In early 2013, Wells Fargo moved, unopposed, for summary judgment. JS ¶¶ 34-35. Judgment against the Partnership was entered in July 2013. JS ¶ 37.

On September 9, 2013, Corey told BFIM that the foreclosure would proceed unless the Bonds were purchased from MCAP III. Dkt. 216 [Gladstone Exs.] at 12 (Corey email to Ken Cutillo at BFIM). The next day, Corey sent ILP and SLP a notice of sheriff's sale dated August

¹⁶ *See. e.g.*, Dkt. 335 [Berning Aff.] at 10 (7/30/2009 Corey email to Robert Major at BONY); *id.* 22 (9/25/2009 Corey email to Major).

¹⁷ Gladstone's letter received no response. Dkt. 216 [Gladstone Aff.] ¶ 9.

9, 2013. JS ¶ 36; Dkt. 216 [Gladstone Exs.] at 14-16 (Corey email to Melissa Curran at BFIM). ILP moved to intervene and for relief from the judgment; on December 20, 2013, the Indiana Superior Court granted ILP's emergency motions, vacating the judgment. Dkt. 44 (Foreclosure Action orders). The Indiana court stayed the Foreclosure Action in favor of this litigation on July 16, 2014,¹⁸ later granting partial relief from the stay to appoint a receiver for the Project during the pendency of the Foreclosure Action. Dkt. 246 (2/10/2016 Foreclosure Action order). The stay otherwise remains in full force and effect. *Id.* at 15.

The instant Amended Complaint asserts eleven causes of action.¹⁹ Dkt. 169 (AC). Defendants previously moved to dismiss the AC (Dkt. 63; Dkt. 72), and the court dismissed the ninth and fourteenth causes of action. Dkt. 103 (MTD Order). On July 21, 2015, the Appellate Division dismissed the first, sixth, and tenth causes of action against Millrun GP, the second cause of action against MCAP II, the third, eighth, twelfth, and thirteenth causes of action against MCAP II and Corey, the fourth cause of action against Millrun GP and Corey, the seventh cause of action against MCAP II, MCAP II Developer LLC, Corey, and MCAP III, and

¹⁸ The instant action was filed on November 13, 2013.

¹⁹ The AC and the parties' briefs refer to plaintiffs' causes of action as "counts" and label them by Roman numerals. The AC asserts: (I) breach of fiduciary duty against Millrun, MCAP II, and Corey; (II) aiding and abetting breach of fiduciary duty against MCAP II and Corey; (III) breach of contract (the Partnership Agreement) against Millrun, MCAP II, and Corey; (IV) breach of contract (the Loan Agreement and the Indenture) against Millrun, MCAP II, and Corey; (V) constructive fraud against Millrun, MCAP II, and Corey; (VI) gross negligence against Millrun, MCAP II, and Corey; (VII) unjust enrichment against MCAP II, Corey, MCAP III, and the Developer; (VIII) indemnification against Millrun, MCAP II, and Corey; (IX) an accounting against Millrun, MCAP II, and Corey; (X) fraud against Millrun, MCAP II, and Corey; (XI) breach of contract (the Guaranty) against MCAP II and Corey; (XII) breach of contract (the Partnership Agreement) against Millrun, MCAP II, and Corey; (XIII) indemnification against Millrun, MCAP II, and Corey; and (XIV) an accounting against MCAP II. Causes of action I through IX are derivatively brought on behalf of the Partnership. ILP asserts causes of action X through XIV directly.

the eleventh cause of action against Corey. As to the remaining causes of action, the Appellate Division held that “the loan and financing agreement, as well as the trust indenture, both of which are governed by Indiana law, indicates that MCAP III had the duty to act reasonably toward the Partnership.” *MMA Meadows*, 130 AD3d 529 at 530–31.

The following causes of action remain: (I) breach of fiduciary duty against MCAP II and Corey; (II) aiding and abetting breach of fiduciary duty against Corey; (III) breach of contract (the Partnership Agreement) against Millrun GP; (IV) breach of contract (Loan Agreement and Indenture) against MCAP III; (V) constructive fraud against Millrun GP, MCAP II, and Corey; (VI) gross negligence against MCAP II and Corey; (VIII) indemnification against Millrun GP; (X) fraud against MCAP II and Corey; (XI) breach of contract (the Guaranty) against MCAP II; (XII) breach of contract (the Partnership Agreement) against Millrun; and (XIII) indemnification against Millrun GP. Causes of action I through IX are derivatively brought on behalf of the Partnership. ILP asserts causes of action X through XIII directly.

MCAP II counterclaimed for breach of the Partnership Agreement against ILP and for declarations of its rights regarding the developer fee, B Bonds, and the Partnership Agreement. MCAP III counterclaimed for breach of the Loan Agreement and Indenture against the Partnership, requesting a declaration of amounts owed due to the alleged breach.

II. Discussion

A. Legal Standards

1. Summary Judgment

Summary judgment may be granted only in the absence of any triable issue of fact. *Alvarez v Prospect Hosp.*, 68 NY2d 320, 325 (1986). The movant bears the burden of showing prima facie entitlement to summary judgment as a matter of law. *Zuckerman v City of New York*,

49 NY2d 557, 562 (1980); *Friends of Animals, Inc. v Associated Fur Mfrs., Inc.*, 46 NY2d 1065, 1067 (1979). The motion must be “supported by affidavit, by a copy of the pleadings and by other available proof, such as depositions and written admissions.” CPLR 3212(b). Failure to make a prima facie showing requires denial of the motion, regardless of the sufficiency of the opposing papers. *Ayotte v Gervasio*, 81 NY2d 1062, 1063 (1993). The evidence submitted on the motion must be examined in the light most favorable to the parties opposing summary judgment. *Martin v Briggs*, 235 AD2d 192, 196 (1st Dept 1997).

Once the movant has laid bare its proof, the opposing party is compelled to do the same. *Bennett v Health Mgt. Sys., Inc.*, 92 AD3d 29, 38 (1st Dept 2011). A failure to contradict facts is an admission. *Costello Assocs., Inc. v Standard Metals Corp.*, 99 AD2d 227, 229 (1st Dept 1984), *appeal dismissed*, 62 NY2d 942 (1984). Mere conclusions, unsubstantiated allegations, or expressions of hope are insufficient to defeat a summary judgment motion. *Zuckerman*, 49 NY2d at 562. One opposing a motion for summary judgment must produce evidentiary proof in admissible form sufficient to require a trial of material questions of fact on which he rests his claim, or must demonstrate an acceptable excuse for his failure to offer admissible evidence. *Id.* Nor can summary judgment be defeated by the “shadowy semblance of an issue.” *Jeffcoat v Andrade*, 205 AD2d 374, 375 (1st Dept 1994). Although hearsay evidence may be considered in opposition to a motion for summary judgment, it is insufficient to bar summary judgment if it is the only evidence submitted. *Arnold v NY City Hous. Auth.*, 296 AD2d 355, 356 (1st Dept 2002). Upon the completion of the court’s examination of the submitted documents, the summary judgment motion must be denied if there is any doubt as to the existence of a triable issue of fact. *Rotuba Extruders, Inc. v Ceppos*, 46 NY2d 223, 231 (1978).

2. Contractual Interpretation – Indiana Law

Under both Indiana law—which governs the Partnership Agreement—and New York law, construction of an unambiguous written contract is a question of law. *TW Gen. Contracting Servs., Inc. v First Farmers Bank & Tr.*, 904 NE2d 1285, 1288 (Ind Ct App 2009); accord *W. W. W. Assocs., Inc. v Giancontieri*, 77 NY2d 157, 162 (1990). “The ultimate goal of any contract interpretation is to determine the intent of the parties at the time that they made the agreement.” *Citimortgage, Inc. v Barabas*, 975 NE2d 805, 813 (Ind 2012); accord *Greenfield v Philles Records, Inc.*, 98 NY2d 562, 569 (2002). Interpretation of a contract “begin[s] with the plain language of the contract, reading it in context and, whenever possible, construing it so as to render each word, phrase, and term meaningful, unambiguous, and harmonious with the whole.” *Citimortgage*, 975 NE2d at 813; accord *Brad H. v City of New York*, 17 NY3d 180, 185 (2011) (“[L]anguage should not be read in isolation because the contract must be considered as a whole.”). “A court should construe the language of a contract so as not to render any words, phrases, or terms ineffective or meaningless.” *Carroll Creek Dev. Co. v Town of Huntertown*, 9 NE3d 702, 709 (Ind Ct App 2014); accord *In re Estate of Margolin*, 259 AD2d 396, 397 (1st Dept 1999) (holding that contractual interpretation that renders words surplusage “should be avoided where possible”).

B. Cause of Action X: Direct Fraud Against MCAP II and Corey

ILP moves for partial summary judgment on its direct fraud claim as against MCAP II and Corey, contending MCAP II and Corey falsely certified the DSCR to induce ILP to pay the Third Installment. MCAP II and Corey oppose and move for summary judgment in their favor.

“In an action to recover damages for fraud, the plaintiff must prove a misrepresentation or omission of material fact which was false and known to be false by defendant, made for the

purpose of inducing the other party to rely upon it, justifiable reliance of the other party on the misrepresentation or material omission, and injury.” *Lama Holding Co. v Smith Barney Inc.*, 88 NY2d 413, 421 (1996).²⁰ “The elements of fraud are narrowly defined, requiring proof by clear and convincing evidence.” *Gaidon v Guardian Life Ins. Co. of Am.*, 94 NY2d 330, 349–50 (1999). ILP has shown, by clear and convincing evidence, that MCAP II and Corey, with knowledge and intent, falsely certified the DSCR to induce ILP to pay the Third Installment, that ILP justifiably relied on the certification, and that ILP suffered resulting monetary damages.

To calculate the DSCR, Reznick was to subtract, from Cash Receipts, all ***cash requirements*** “properly allocable” to the three-month period “on an accrual basis” and “on an annualized basis, all ***projected expenditures***” (the numerator), and to divide the result by all Debt Service Requirements (the denominator). Dkt. 183 (Partnership Agreement) at 6 (emphasis added). The Partnership Agreement further specifies that “projected expenditures” include “those of a seasonal nature which might reasonably be expected to be incurred on an unequal basis during a ***full annual period of operation.***” *Id.* (emphasis added). Further, “***cash requirements*** of the Partnership shall include ***to the extent not otherwise covered above***, full funding of reserves

²⁰ All parties agree that New York law applies to the tort claim of fraud. In any event, the elements are essentially the same in Indiana and Delaware. *See Snyder v Smith*, 7 F Supp 3d 842, 878 (SD Ind 2014); *Black Horse Capital, LP v Xstelos Holdings, Inc.*, 2014 WL 5025926, at *21 (Del Ch 2014). The GP Defendants are based in New York.

[e.g., the § 6.12(A) Reserve²¹], normal repairs and necessary capital improvements ...”²² *Id.* (emphasis added). Reznick’s corporate representative testified that to “annualize” expenses meant dividing the total annual number by twelve. Dkt. 215 [Early Exs.] at 328 (Henigan Dep. 42:7-15); *id.* at 339 (Henigan Dep. 89:2-4). While the representative did not testify as to the meaning of “projected expenditures”, both sides’ experts agreed that “projected expenditures” included quantifiable expenses that management knew would be incurred. *Id.* at 180 (Gruber Dep. 217:4-15); *id.* at 435-36 (Nelson Dep. 125:5-126:2).

The Certificate, signed by Corey on behalf of MCAP II as manager of Millrun GP, stated: “The Partnership has achieved a Debt Service Coverage Ratio of 111% for each of three (3) consecutive months, as evidenced by the [AUP Report].” Dkt. 215 [Early Exs.] at 943. Disputing ILP’s contention that this was a misrepresentation, MCAP II and Corey proffer expert testimony defending the AUP Report’s accuracy. The AUP Report, in turn, relied on the Schedule, based on information provided by Zephyr. The Schedule was also modified by Reznick at Zephyr’s

²¹ Plaintiffs do not dispute defendants’ inclusion of **Replacement Reserve** deposits in Debt Service Requirements (denominator) rather than in Cash Available for Debt Service Requirements (numerator). The court agrees with this inclusion because the Partnership Agreement defines Debt Service Requirements to include “cash requirements imposed by the Mortgage Loan Documents,” which includes cash requirements imposed by the Reserve Agreement executed in connection with the Bonds—whose repayment obligations were secured by the Property. Dkt. 183 (Partnership Agreement) at 8, 14.

²² The DSCR can be expressed as follows:

$$\text{DSCR} = \frac{\text{Cash Available for Debt Service Requirements}}{\text{Debt Service Requirements}}$$

Cash Available for Debt Service Requirements (the DSCR numerator) can be expressed as

$$\begin{aligned} & \text{Cash Receipts} \\ & - \text{cash requirements (accrual basis)} \\ & - \text{projected expenditures (annualized basis)} \\ & \hline & \text{Cash Available for Debt Service Requirements} \end{aligned}$$

direction. The Schedule unquestionably omits two items: (1) the insurance loss—a \$25,000 deductible toward work performed in November and December 2008—carried on Equity’s books until March 2009 at Zephyr’s direction; and (2) the pool improvements—a \$23,000 estimate obtained in December 2008 and a necessary expense before the pool could reopen for the 2009 operating season. Plaintiffs argue that these costs reflect “projected expenditures” that should be annualized and included in the DSCR in the test period. When the pool costs and insurance loss are included, along with capital expenditures that Reznick excluded at Zephyr’s direction and contrary to the Partnership Agreement, the DSCR fails to achieve 111% in November and December 2008:

	November 2008	December 2008
DSCR Numerator (reported in AUP Report)	46,208	47,112
Capital Expenditures (reported in AUP Report)	1,966	(345)
Annualized Pool Improvements (\$23,000 ÷ 12)	1,917	1,917
Annualized Insurance Loss (\$25,000 ÷ 12)	2,111	2,111
DSCR Numerator (newly adjusted)	40,214	43,429
DSCR Denominator (reported in AUP Report)	39,618	39,618
DSCR (newly adjusted)	101.5%	109.6%

While MCAP II and Corey note correctly that the Partnership Agreement vested Reznick with power to “determine” the DSCR numerator and to “confirm” the DSCR, it is uncontroverted that MCAP II and Corey *failed to disclose to Reznick* the \$23,000 pool repairs and the \$25,000 insurance loss. The record reflects that this omission was intentional. MCAP II and Corey cannot rely on Reznick’s determination or confirmation of the DSCR or any component thereof when they knowingly and intentionally did not disclose projected expenses to Reznick, thereby assuring their omission from the calculation.

MCAP II and Corey argue that capital expenses were properly omitted because the Replacement Reserve covered the pool improvements and insurance loss.²³ This is irrelevant. “All projected expenditures” include capital expenditures, regardless of whether the Partnership employs or is reimbursed by reserve funds. MCAP II and Corey proffer the explanation of Reznick’s corporate representative, Ryan Henigan, and defendants’ expert witness, Dr. Arnold Gruber, that counting in the denominator the Replacement Reserve deposits as a Debt Service Requirement and counting in the numerator capital expenses covered by Replacement Reserve disbursements as annualized projected expenditures would impermissibly double count identical expenses. The court rejects defendants’ double counting theory and holds that capital expenditures are included in “all projected expenditures” *regardless* of whether or not they are covered by Replacement Reserve disbursements.

To begin, as a matter of plain language, even if Replacement Reserve deposits are a Debt Service Requirement, *capital expenditures* are not *themselves* Debt Service Requirements because such expenditures are not “*cash requirements* imposed by the Mortgage Loan Documents.” While the loan documents require the Partnership to keep the Project in good repair, they do not specify a *cash requirement* for any such repairs apart from Replacement Reserve deposits. *See, e.g.*, Dkt. 186 (Loan Agreement) at 25 (§ 5.2(q)), 28 (§ 5.2(hh)).²⁴

²³ The GP Defendants argue that the Replacement Reserve contained roughly **\$44,000** at the end of 2008, but provide no evidence that those funds were earmarked for the disputed expenses. Moreover, the pool estimate was \$23,000 and the insurance loss was \$25,000, for a total of **\$48,000**. A third disputed expense, the Campbell Invoices, totaled a *further* \$3,920.29.

²⁴ The GP Defendants also argue that the qualifying phrase “to the extent not otherwise covered above” excludes from “*cash requirements*” any “capital improvements” purportedly “covered” by Replacement Reserve deposits (a Debt Service Requirement). This is of indirect relevance because plaintiffs argue for inclusion of annualized pool and insurance costs in “all projected expenditures”, not “all cash requirements”. Regardless, capital improvements are neither Debt

Additionally, separate accounting for projected capital expenditures and reserve deposits is consistent with the rest of the DSCR definition. The DSCR expressly counts reserve deposits and payment of expenses from disbursements even *within* the numerator: “all cash requirements” include, “to the extent not otherwise covered above [e.g., as a Debt Service Requirement], *full funding of reserves [and] normal repairs and necessary capital improvements.*” Dkt. 183. (Partnership Agreement) at 6 (emphasis added). The funding of “reserves”—while the term is not defined—includes monthly deposits of \$4,250 into the § 6.12(A) Reserve,²⁵ which is to be “utilized solely to fund capital repairs and improvements deemed necessary by the General Partners.” *Id.* at 46. Thus, even if the Partnership withdrew and spent \$4,250 from the § 6.12(A) Reserve one month, the DSCR counts two separate, identical expenses as “cash requirements” for that month: payment for the repairs and improvements, and funding the § 6.12(A) Reserve. Counting § 6.12(A) Reserve deposits and capital improvements each as separate “cash requirements”, rather than a single line item, provides a clearer picture of the Partnership’s financial health—the *raison d’être* of the DSCR test—because it causes the DSCR to reflect whether funds in the § 6.12(A) Reserve are being *depleted*, on net, rather than accumulated. Subscribing to the defendants’ double counting theory to exclude \$3,400 in capital expenses per month from projected expenditures is discordant with the treatment of reserves within “cash

Service Requirements nor “otherwise covered” therein, and there is no basis for excluding such expenditures from “cash requirements” in Cash Available for Debt Service Requirements.

²⁵ In practice, the Partnership may have fulfilled the § 6.12(A) requirement by deposits to the Replacement Reserve as a Debt Service Requirement (in the DSCR denominator) required by a Mortgage Loan Document rather than a “cash requirement” accounted for within the Cash Available for Debt Service Requirements (numerator) as explicitly contemplated by the DSCR definition. That the November 1, 2007 Reserve Agreement is dated the year *following* the June 13, 2006 Partnership Agreement accounts for this seeming discrepancy.

requirements”. Conversely, simultaneously counting Reserve Account deposits in Debt Service Requirements and annualized capital expenditures in “all projected expenditures” harmonizes treatment of the Reserve Account deposits with the overall scheme. *See Citimortgage*, 975 NE2d at 813 (noting that contracts should be construed, wherever possible, “so as to render each word, phrase, and term ... harmonious with the whole”).²⁶

Finally, the definition of “Operating Expenses”²⁷ includes “all the costs and expenses of any type incurred incidental to the ownership and operation of the Project, including, without limitation ... capital improvements reasonably deemed necessary by the General Partners *and not funded out of any reserves for such.*” Dkt. 183 (Partnership Agreement) at 14 (emphasis added). The phrase “and not funded out of any reserves for such” is only necessary because capital improvement “costs and expenses” by default *include* amounts covered by reserve funds such as the § 6.12(A) Reserve or the Replacement Reserve. *See Carroll*, 9 NE3d is 709 (“A court should construe the language of a contract so as not to render any words, phrases, or terms ineffective or meaningless.”). Accordingly, Reznick’s exclusion from projected expenditures of capital expenditures allegedly covered by the Replacement Reserve was error.²⁸

²⁶ Notably, amounts released from escrow cannot be used to offset Partnership expenses in the DSCR. “Cash Receipts” for a *fiscal year* include such funds, but “Cash Receipts” for purposes of the DSCR—calculated monthly—do not. *See* Dkt. 183 (Partnership Agreement) at 6.

²⁷ The term “Operating Expenses” is used for, *inter alia*, defining Millrun GP’s obligations to fund Operating Expense deficits and to specify permitted uses of the Operating Reserve. *See* Dkt. 183 (Partnership Agreement) at 45-46. The DSCR definition does not use the term.

²⁸ Moreover, even if Reznick correctly excluded capital improvements from the Cash Available for Debt Service (the DSCR numerator), the GP Defendants intentionally omitted the pool improvements and insurance loss—both known Partnership expenses—from all three months of the *Schedule, including January 2009*.

MCAP II and Corey next argue that the November and December 2008 DSCR properly excluded the pool expense because it was projected to accrue in 2009—unlike the insurance loss, which defendants’ expert *admitted* was incurred in 2008 and should have been annualized in November and December. Dkt. 215 [Early Exs.] at 189 (Gruber Dep. 253:19-255:5). Defendants’ expert testified that “on an annualized basis, all projected expenditures” meant expenses must be annualized as “two separate [calendar] years” (Dkt. 215 [Early Exs.] at 190-91 (Gruber Dep. 260:5-261:13))—that is, the DSCR for *November and December 2008* could only include expenses paid or projected to be paid *in 2008*.

MCAP II and Corey’s interpretation is belied by the plain meaning of the phrase “*all projected expenditures*”, which should reflect *future* expectations rather than *past* behavior. While future expectations are informed by past behavior, such expectations necessarily include *known future expenses*, such as the firm estimate for the pool repairs. But even if defendants’ interpretation were reasonable, Reznick never considered whether the \$23,000 estimate for pool repairs was properly excluded from November and December 2008 because Zephyr never disclosed them to Reznick. The Schedule likewise showed zero dollars in pool improvements for any of the three months, *including January 2009*. In addition, Zephyr excluded the pool repairs and insurance loss from the 2009 budget. No evidence suggests that Reznick exercised *any* judgment to exclude the pool improvements and insurance loss.²⁹ Rather, the evidence shows

²⁹ Cases cited by Defendants that held that reliance on another’s professional judgment may negate scienter for fraud, therefore, are distinguishable. *See, e.g., S.E.C. v Caserta*, 75 F Supp 2d 79, 94 (EDNY 1999); *In re Livent, Inc. Noteholders Sec. Litig.*, 151 F Supp 2d 371, 410 (SDNY 2001). Nor does *D’Amour v Ohrenstein & Brown, LLP*, 17 Misc 3d 1130(A) (Sup Ct NY County 2007), support this proposition. *See id.* at *14 (dismissing fraud claim where statement that defendant had simply *received* tax opinion was not misrepresentation because all parties

that MCAP II and Corey intentionally misrepresented to ILP the projected expenditures and the DSCR calculations stemming from them.³⁰

MCAP II and Corey further argue that BFIM could not have reasonably relied on the DSCR calculation because BFIM had the opportunity and contractual right to confirm it before making the Third Installment. They are mistaken. Under the terms of the Partnership Agreement, Millrun GP is a fiduciary of the Partnership and the Limited Partners. *See, e.g.*, Dkt. 183 (Partnership Agreement) at 36 (§§ 6.4(G) and (H)). Beneficiaries of a fiduciary relationship may reasonably rely on information provided by the fiduciary without obligation to perform an independent audit. *See Andersen ex rel. Andersen, Weinroth & Co., L.P. v Weinroth*, 48 AD3d 121, 136 (1st Dept 2007) (“[Plaintiff] was reasonably justified in relying on [defendant’s] representations concerning his capital contributions without having to perform his own independent inquiries.”); *TPL Assocs. v Helmsley-Spear, Inc.*, 146 AD2d 468, 471 (1st Dept 1989); *Frame v Maynard*, 83 AD3d 599, 602 (1st Dept 2011). As beneficiaries of Millrun GP’s fiduciary status, ILP reasonably relied on the truthfulness of the Certificate, including the AUP

admitted he *had* received it). Further, full disclosure and good faith, both of which are required to negate scienter, are absent here. *See Caserta*, 75 F Supp 2d at 95.

³⁰ ILP also argues for inclusion of the (annualized) Campbell Invoices, which were dated October 31, 2008 and paid in March 2009. MCAP II and Corey argue against such inclusion, alleging that those expenses accrued one day before the test period. Management intended to pay Campbell *after* the test period from funds accrued *during or after* the test period, as Equity’s corporate representative testified that the property did not previously have enough money to pay the bill. Dkt. 215 [Early Exs.] at 506 (Potvin Dep. 81:20-82:14). To argue, as MCAP II and Corey do, that the Campbell Invoices did not reflect a projected expenditure suggests that the Partnership could hold a past-due October 2008 invoice in an amount it could not afford to pay, nominally “pass” the DSCR test over the following three months, and only then pay the invoice from funds received during or after the test period. The court nevertheless does not reach the treatment of the Campbell Invoices because their annualized cost—\$327—is not mathematically significant to the calculations here.

Report, the Schedule, and the 2009 annual budget that excluded the pool improvements and insurance loss. Moreover, MCAP II and Corey proffer no evidence that ILP had independent means to uncover the deferral of \$50,000 in unaccounted expenses by exercise of due diligence *prior* to the Third Installment payment.³¹ See *Zuckerman*, 49 NY2d at 562 (noting that unsubstantiated allegations are insufficient to create genuine issue of material fact). To the extent ILP made its own calculations resulting in an 111% or higher DSCR, MCAP II and Corey undisputedly provided inaccurate data to ILP, and proffer no evidence that the undisclosed expenses were included in ILP's calculations. ILP's failure to raise issues before litigation—absent any evidence these issues were brought to its attention—does not raise a question of material fact as to fraud.³²

In seeking summary judgment on all of plaintiffs' claims, MCAP II and Corey allege that plaintiffs cannot show damages. Specifically, as to fraud, MCAP II and Corey argue that BFIM attained its admitted goal of receiving tax credits in recoupment of its \$5.3 million investment, plus additional tax benefits from operating losses. In MCAP II and Corey's view, the requested

³¹ Defendants cite *HSH Nordbank AG v UBS AG*, 95 AD3d 185 (1st Dept 2012) and *MP Cool Invs. Ltd. v Forkosh*, 142 AD3d 286 (1st Dept 2016) to support their position that plaintiffs did not reasonably rely on the misrepresentations. The holdings of those cases reflected plaintiffs' ability to uncover the alleged misrepresentations *before* acting. See *HSH Nordbank*, 95 AD3d at 188-89 ("HSH could have uncovered any misrepresentation of the risk of the transaction through the exercise of reasonable due diligence ..."); *Forkosh*, 142 AD3d at 291-92 ("Plaintiff had total, unfettered access to every aspect of [the] company information both before and after its initial investment, even before it held a controlling interest ..."). Defendants here do not contend plaintiffs could have learned of the undisclosed expenses until after payment of the Third Installment. Then too, unlike in the cited cases, a fiduciary provided the misinformation here.

³² MCAP II and Corey also complain that ILP's *initial* fraud allegations, as pled, inappropriately relied on inferences drawn from statements prepared on an *annual* rather than monthly basis. The DSCR is calculated on a monthly basis. That the pleaded *allegations* reflect information in plaintiffs' possession at a time prior to the conclusion of fact discovery did not waive plaintiffs' right to use later-obtained information to *prove* their fraud claim.

award would amount to double recovery—tax credits in the amount of BFIM’s investment (including the Third Installment) and fraud damages in the amount of the Third Installment. In this vein, MCAP II and Corey argue that ILP obtained the “benefit of its bargain”³³ because the Partnership Agreement entitled ILP to a dollar-for-dollar refund of its capital contributions in the amount of any tax credit shortfall (i.e., projected³⁴ minus actual tax credits) and required ILP to make a dollar-for-dollar increase in its capital contributions in the amount of any tax credit windfall (i.e., actual minus projected tax credits). Double recovery does not apply here.³⁵

“In a fraud action, a plaintiff may recover only the actual pecuniary loss sustained as a direct result of the wrong.” *Cont’l Cas. Co. v PricewaterhouseCoopers, LLP*, 15 NY3d 264, 271, (2010), citing *Reno v Bull*, 226 NY 546 (1919). “Under this rule, the actual loss sustained as a direct result of fraud that induces an investment is the ‘difference between the value of the bargain which a plaintiff was induced by fraud to make and the amount or value of the

³³ To support their “benefit of the bargain” theory, defendants’ reply papers cite *Indiana Bell Tel. Co. v Ice Serv., Inc.*, 231 NE2d 820 (Ind Ct App 1967), a ***breach of contract*** action in which the appellate court remarked that the trial court’s erroneous instruction had “placed the injured party in a better position than it would have been if the contract had been performed.” *Id.* at 825. Being defrauded of over a million dollars (which occurred here) rarely accrues to the victim’s benefit.

³⁴ Projected tax credits under the Partnership Agreement were fixed at \$4,899,510. Dkt. 183 (Partnership Agreement) at 16.

³⁵ The double recovery cases cited by MCAP II and Corey do not bar recovery in this case. In *Curtis v Clem*, 689 NE2d 1261 (Ind Ct App 1997), the court reviewed a post-verdict reduction of a jury award in the amount of a pretrial payment in partial satisfaction of a claim, and reversed the reduction because the pretrial payment was before the factfinder when it determined damages. *Id.* at 1264-65. Next, the quotation by *Mt. Pleasant Special Sch. Dist. v Gebhart*, 378 A2d 146 (Del Ch.1977), cites a ***worker’s compensation treatise***; the court there ruled that the principle against double recovery did ***not*** apply. *Id.* at 148, 150. *INS Investigations Bureau, Inc. v Lee*, 784 NE2d 566, 577 (Ind Ct App 2003), bars judgments awarding duplicative damages in the same legal proceeding on the same injury based on multiple causes of action. Similarly, *Zarcone v Perry*, 78 AD2d 70 (1980), *aff’d* (2nd Dept 1981) bars actions seeking duplicative damages where *res judicata* applies from a prior legal proceeding. Neither the circumstances present in *INS* nor *Zarcone* are found here.

consideration exacted as the price of the bargain.” *Id.*, quoting *Sager v Friedman*, 270 NY 472, 481 (1936). Consequently, “a plaintiff alleging fraudulent inducement is limited to ‘out of pocket’ damages, which consist solely of the actual pecuniary loss directly caused by the fraudulent inducement.” *Kumiva Grp., LLC v Garda USA Inc.*, 146 AD3d 504, 506 (1st Dept 2017). These damages are calculated in three steps:

First, the plaintiff must show the actual value of the consideration it received. Second, the plaintiff must prove that the defendant's fraudulent inducement directly caused the plaintiff to agree to deliver consideration that was greater than the value of the received consideration. Finally, the difference between the value of the received consideration and the delivered consideration constitutes “out of pocket” damages.

Id. ILP has successfully demonstrated that it paid the \$1,150,434 Third Installment in “consideration exacted as the price of the bargain.” As to the “actual value of the consideration received,” paying the Third Installment—which was not due and owing—conferred no direct benefit on ILP.³⁶ Achievement of a 111% DSCR was a condition precedent to payment of the Third Installment, even as the *amount* of capital contributions was contingent on received tax credits.³⁷ Moreover, Partnership tax credit allocation was made according to ownership

³⁶ Third Installment proceeds went to MCAP II Developer LLC and MCAP III, Partnership creditors. As the GP Defendants allege that the Partnership is hopelessly underwater, they cannot argue that plaintiff has a reasonable expectation of receiving value from their ownership interest that is dollar-for-dollar equal to the reduction of the Partnership's liabilities.

³⁷ Under the Partnership Agreement, any increase in ILP's capital contribution was to be applied to the installment *following* a tax credit windfall—here, the Third Installment. Dkt. 183 (Partnership Agreement) at 23 (“If, upon the occurrence of any determination or event giving rise to an adjustment in the Capital Contribution of the Investor Limited Partner under this Section ..., there is a net increase in such Capital Contribution, then such net increase shall be divided equally among any Installments remaining unpaid”). Whether the Third Installment was payable, however, remained contingent on the DSCR test and unaffected by any tax credit windfall. *See* Dkt. 183 (Partnership Agreement) at 24 (“[T]he third Installment ... shall be

percentage, *not* capital contributions. Defendants present no evidence that availability of any tax credits received by ILP depended on payment of the Third Installment. Therefore, ILP incurred “out of pocket” damages as a result of the fraud by paying \$1,150,434 that it did not owe.

ILP has demonstrated by clear and convincing evidence that MCAP II and Corey knowingly misrepresented facts regarding projected expenditures and resultant DSCR calculations; that these misrepresentations were material because the DSCR was not met when the reported capital expenditures, annualized projected pool costs,³⁸ and annualized insurance loss were properly included in the November and December 2008 DSCR; that Corey and MCAP II made these misrepresentations to induce ILP to pay the Third Installment; and that ILP justifiably relied on the misrepresentations and was injured as a result. Hence, summary judgment is granted to ILP on cause of action X against Corey and MCAP II.

C. Causes of Action III (Derivative) and XII (Direct): Breach of Contract (the Partnership Agreement) against Millrun GP

Plaintiffs—ILP in its own capacity (cause of action XII) and ILP and SLP in their derivative capacity on the Partnership’s behalf (cause of action III)—move for partial summary judgment for breach of the Partnership Agreement against Millrun GP. Plaintiffs contend that Millrun GP breached its obligations under the Partnership Agreement by paying interest on the Series B Bonds to MCAP II and failing to defend the Foreclosure Action. It also contends that

payable on the *later* of ... (b) the date the Partnership achieves a 111% Debt Service Coverage Ratio for each of three (3) consecutive months” (emphasis added)).

³⁸ Together, the insurance loss and reported but excluded capital expenditures were sufficient to cause the DSCR test to fail in November 2008, as follows: Had the pool estimate been properly omitted from the November 2008 calculation, the DSCR numerator without it is $46,208 + 1,966 + 2,111 = 42,131$ and the resulting DSCR is $42,131 \div 39,618 = 106.3\%$. Likewise, the pool expenses and insurance loss, without the reported but excluded capital expenditures, were sufficient to cause failure of the DSCR test in December 2008, as no capital expenditures were reported that month, only a gain of \$345.

Millrun GP breached the warranties of Partnership Agreement §§ 6.5(ii), (iii), (xi), (xii), and (xix) made to ILP. Millrun GP cross-moves, arguing that there were no resulting damages. Millrun GP's payment of Series B Bond interest breached the Partnership Agreement, causing all of the harms alleged under causes of action III and XII.

Plaintiffs contend that paying interest on the Series B Bonds to MCAP II breached the Partnership Agreement in several ways: 1) the DSCR test was never met; 2) debt service on the B Bonds was payable only out of Partnership cash flow, which was negative at all relevant times; and 3) interest on the Series B Bonds should not have been paid while money was owed on the Series A Bonds. Plaintiffs argue that had Millrun GP withheld interest payments on the Series B Bonds, the Partnership could have satisfied its other obligations, including the July 2009 debt service on the A Bonds. While admitting that MCAP II received \$263,000 in ordinary interest on the Series B Bonds in May and June 2009, Millrun GP responds that because the DSCR test was met, debt service on the Series B Bonds was a contractually mandated operating expense and was payable from operating expense loans.

Under the Trust Indenture, "no payment shall be due or payable on the Series B Bonds until the earlier of (A) the day on which the Debt Service Coverage Ratio has met or exceeded 1.11 for any period of three consecutive months on or after the Closing Date or (B) December 1, 2010...." Dkt. 185 (Trust Indenture) at 30-31. The parties agree that payment on the Series B Bonds was subject to the same DSCR test as the Third Installment. *See* Dkt. 277 (GP Defs.' Opp. Br.) at 16; Dkt. 291 (Pls.' Reply Br.) at 16. As the January 2009 DSCR test failed, plaintiffs have demonstrated that Series B Bond debt service was not due and payable when Millrun GP paid the ordinary interest on them in May and June 2009.

Millrun GP had fiduciary duties under § 6.4(G) of the Partnership Agreement to safekeep and use Partnership assets for the Partnership's exclusive benefit. Dkt. 183 (Partnership Agreement) at 36. Prepaying ordinary interest on the Series B Bonds to its affiliate, MCAP II, and consequently causing default on the Series A Bonds,³⁹ violated these duties. The Series B Bond payments damaged the Partnership in the undisputed amount of those payments: \$263,088.04 on May 1, 2009, and \$13,333 on June 1, 2009. *See* JS ¶ 23; Dkt. 328 (Johnson 10/26/15 Tr.) 237:13-238:16; Dkt. 334 (Nelson Rpt.) at 32 ¶ 11. It also resulted in the default of the Series A Bonds, interest and late payments due on them and the Foreclosure Action.

Moreover, § 6.4(G) obligated Millrun GP to defend the Foreclosure Action with any good faith defenses available and safekeep Partnership assets. Millrun GP was obligated to hire counsel on behalf of the Partnership⁴⁰—independent from MCAP II or MCAP III, who admit a conflict of interest, *see* Dkt. 277 (GP Defs.' Opp. Br.) at 23-24—to defend the Project from foreclosure on any available legal grounds. The Indiana court found that the Partnership likely did have defenses. Dkt. 44 (12/20/2013 Foreclosure Action orders) at 4-5. ILP's later intervention in the Foreclosure Action—at its own cost—did not excuse Millrun GP's breach of its duty. Millrun GP's breaches of its obligations under § 6.4(G) also breached its continuing warranty to ILP under § 6.5(xi), which states that “[n]o General Partner is in default in any

³⁹ The alleged unreasonable delay of ILP's consent to release Operating Reserve funds to pay Series A debt service is of no consequence where no Operating Reserve funds should have been necessary in the first place.

⁴⁰ While Millrun GP hired a lawyer to file the Partnership's answer (admitting the default), any lawyer representing the Partnership in the Foreclosure Action retained his or obligation to act in the best interests of his client—the Partnership—rather than Millrun GP. *See* Indiana Professional Conduct Rule 5.4(c) (“A lawyer shall not permit a person who recommends, employs, or pays the lawyer to render legal services for another to direct or regulate the lawyer's professional judgment in rendering such legal services.”).

material respect in the observance or performance of any provision of this Agreement to be observed or performed by such General Partner.” Dkt. 183 (Partnership Agreement) at 39-40.

Millrun GP contends that that the default and Foreclosure Action (its pendency and Millrun GP’s refusal to defend) did not harm the Partnership or Limited Partners. Millrun GP does not dispute that the default caused the Partnership to pay default interest in 2009 and owe late fees. *See* Dkt. 335 [Berning Aff.] ¶ 7; *see also* Dkt. 334 (Nelson Expert Rpt.) at 32-33. Legal fees incurred defending against MCAP III’s claims in this action and the Foreclosure Action may also be recovered as damages. *See Masonic Temple Ass’n of Crawfordsville v Ind. Farmers Mut. Ins. Co.*, 837 NE2d 1032, 1039 (Ind Ct App 2005) (“When the defendant’s breach of contract caused the plaintiff to engage in litigation with a third party to protect its interests and such action would not have been necessary but for defendant’s breach, attorney fees and litigation expenses incurred in litigation with a third party may be recovered as an element of plaintiff’s damages from defendant’s breach of contract.”).

As a consequence of Millrun GP’s breach of the Partnership Agreement, the Partnership and ILP were harmed by improper payments on the B Bonds, the default on the Series A Bonds (including default interest accrued and paid by the Partnership), and the Foreclosure Action (including the Partnership and the ILP’s legal fees).⁴¹ Partial summary judgment is granted on causes of action III and XII as to liability, with damages to be determined at trial.

⁴¹ The GP Defendants cite several inapposite cases to support their motion for summary judgment as lack of causation. In *Seidman v Indus. Recycling Properties, Inc.*, 106 AD3d 983, 985 (2nd Dept 2013), the court reversed a summary judgment award of damages because it was not calculated to make good or to compensate plaintiffs for their loss, but did not reverse as to liability. And even if plaintiffs do not meet the standard for *compensatory* damages described in *Strassburger v Earley*, 752 A2d 557, 579 (Del. Ch. 2000), as revised (Jan. 27, 2000), they meet the standard for *consequential* damages dictated in *Rockford Mut. Ins. Co. v Pirtle*, 911 NE2d 60, 67 (Ind. Ct. App. 2009) that “[t]he party seeking damages must prove by a preponderance of

D. Cause of Action XI: (Direct) Breach of Contract (the Guaranty) against MCAP II

ILP moves for partial summary judgment on MCAP II's breach of the Guaranty covering Millrun GP's breaches of the Partnership Agreement and nominal damages as to MCAP II's failure to comply with liquidity⁴² and reporting requirements under the Guaranty. MCAP II argues that a factual dispute exists as to whether ILP materially breached the Partnership Agreement by having "unreasonably withheld or delayed" consent to release of the Operating Reserves, thereby absolving MCAP II of its obligations under the Guaranty.

MCAP II fails to raise a triable issue of material fact. ILP's inquiries before granting consent were *reasonable*, and Corey abandoned efforts to secure a timely release of funds on July 1st, in effect duping Sutton and Voyentzie, BFIM personnel, into not providing timely payment. Crucially, Millrun GP never gave ILP adequate time—only eleven days—to consider Corey's request to release reserves, only several months following Millrun GP's DSCR certifications. It was Millrun GP's contractual and fiduciary responsibility to inform itself and to seek a timely release of funds, not ILP's duty to forego its right to reasonably withhold or delay consent.⁴³ As MCAP II fails to raise any valid defense, partial summary judgment is granted to plaintiffs on MCAP II's liability for Millrun GP's breaches of the Partnership Agreement.

the evidence that the breach was the cause in fact of its loss." *See also id.* ("Consequential damages may be awarded when the non-breaching party's loss flows naturally and probably from the breach and was contemplated by the parties when the contract was made."). Here, plaintiffs have carried their burden of showing that Millrun GP's breach was the "cause in fact" of damages, in an amount to be determined at trial, stemming from the Series B Bonds payments.

⁴² Plaintiffs' opening brief in support of their motion for partial summary judgment cites to unrefuted record evidence and their own expert's opinion that the Guaranty's liquidity requirements were not met.

⁴³ In addition, as Millrun GP and MCAP II failed to discharge their operating expense loan obligations (purportedly having done so to impermissibly pay Series B interest), the Operating

As to the Guaranty's liquidity and reporting requirements, MCAP II does not dispute it failed to maintain \$1 million in liquid assets in one or more years since 2009. Dkt. 323 (Nelson Expert Rpt.) at 38 ¶ 6; Dkt. 330 at 16 (Withal Dep. 54:25-55:9). MCAP II also admits that it failed to timely provide a financial statement for 2015. Dkt. 277 (GP Defs.' Reply Br.) at 26. While plaintiffs do not assert particular damages for these breaches, Indiana law recognizes nominal damages for breach of contract. *Shepard v State Auto. Mut. Ins. Co.*, 463 F.3d 742, 748 (7th Cir. 2006), citing *Am. Fletcher Nat. Bank & Tr. Co. v Flick*, 146 Ind. App. 122, 135 (1969). Ergo, partial summary judgment is granted to plaintiffs for MCAP II's breach of the liquidity and reporting requirements.

E. Causes of Action VIII (Derivative) and XIII (Direct): Indemnification against Millrun GP

Plaintiffs seek summary judgement for contractual indemnification against Millrun GP for all legal fees, costs, and other losses incurred by the ILP and the Partnership in the Foreclosure Action and the Limited Partners in the instant action. Millrun GP argues that plaintiffs are responsible for the expenses and losses of the default and Foreclosure Action. Millrun GP further argues that the Partnership Agreement does not permit recovery of fees incurred in prosecuting any of the first-party claims in the instant action brought by the Limited Partners against Millrun GP, MCAP II, and Corey.⁴⁴

Reserve was not "required" in order to pay July 2009 debt service. *See* Dkt. 183 (Partnership Agreement) at 46 ("Funds in the Operating Reserve may be used to pay Operating Expenses, **to the extent required**, subject to any Requisite Approvals and to the Consent of the Investor Limited Partner." (emphasis added)).

⁴⁴ Plaintiffs do not contest classification of the claims against MCAP II and Corey as first-party claims. These claims arose out of MCAP II and Corey's control of Millrun GP, the only defendant in this action who is a party to the Partnership Agreement. Claims by and against MCAP III, however, are more logically classified as third-party claims because MCAP III does not control Millrun GP.

“The general rule in Indiana is that attorney’s fees are not allowed in the absence of a statute or an agreement or stipulation specially authorizing the allowance.” *England v Alicea*, 827 NE2d 555, 559 (Ind Ct App 2005). Under Indiana law, “indemnification clauses are strictly construed and the intent to indemnify must be stated in clear and unequivocal terms.” *Fresh Cut, Inc. v Fazli*, 650 NE2d 1126, 1132 (Ind 1995). Indemnity clauses are generally understood to cover risk of harm to third persons and shift the financial burden for the payment of damages to compensate for such harm from indemnitee to indemnitor. *L.H. Controls, Inc. v Custom Conveyor, Inc.*, 974 NE2d 1031, 1048 (Ind Ct App 2012). Where an “indemnity provision does not clearly and unambiguously state that it applies to first-party claims, ... it is appropriate to hold that the provision applies only to third-party claims, in accordance with the traditional legal understanding of indemnity provisions.” *Id.*; *see also Flaherty & Collins, Inc. v BBR-Vision I, L.P.*, 990 NE2d 958, 968 (Ind Ct App 2013) (holding that agreement’s failure to state intent to indemnify first-party actions in clear and unequivocal terms, and absent explicit or implicit reference to such actions, failed to “create an exception to the general rule that an indemnity clause creates liability to pay only for third-party actions”).⁴⁵

⁴⁵ The *Plumrose* case cited by plaintiffs applied Delaware law. *See Plumrose (USA) Inc. v Penske Truck Leasing Co., L.P.*, No. 3:04 CV 784, 2005 WL 2416331, at *2 (N.D. Ind. Sept. 30, 2005). The cited *Sequa* and *AM General* cases, applying Indiana law, contained fee-shifting language specific to claims between parties to the contracts in dispute. *See Sequa Coatings Corp. v N. Indiana Commuter Transp. Dist.*, 796 NE2d 1216, 1229 (Ind. Ct. App.) (“Sequa shall hold harmless, defend, and indemnify [...] from any and all Causes of Action, as defined above, **asserted by any parties** and non-parties **to this Agreement**[.]” (emphasis added)), clarification, 800 NE2d 926 (Ind. Ct. App. 2003); *AM Gen. LLC v Demmer Corp.*, No. 3:12CV333, 2013 WL 5348484, at *4 (N.D. Ind. Sept. 23, 2013) (“Seller shall indemnify and hold Buyer harmless to the full extent of any loss, damage or expense, including lost profit, attorney’s fees and court costs, for any failure or alleged failure of Seller to comply with the requirements of this Purchase Order.”).

The indemnification clause at issue, Partnership Agreement § 6.6(E), states as follows:

The General Partners shall defend, indemnify and hold harmless the Partnership and the Limited Partners from any liability, loss, damage, fees, costs and expenses, judgments or amounts paid in settlement incurred by reason of any demands, claims, suits, actions or proceedings arising out of the General Partners' ...⁴⁶ negligence, misconduct, fraud, breach of fiduciary duty or breach of this Agreement, including without limitation any breach by any General Partner ... of any representation, warranty, covenant or agreement set forth in Section 6.5 or elsewhere in this Agreement, including all reasonable legal fees and costs incurred in defending against any claim or liability or protecting itself or the Partnership from, or lessening the effect of, any such breach. ...

Dkt. 183 at 43 (footnote and emphasis added).

Millrun GP is not liable to indemnify the Limited Partners for attorneys' fees and costs in prosecuting direct or derivative claims against Millrun GP, MCAP II, and Corey. Section 6.6(E) does not clearly and unambiguously award prevailing parties' fees, costs, and expenses for first-party claims. Rather, it is generally phrased to indemnify the Limited Partners for fees, costs, and expenses incurred by way of actions arising out of Millrun GP's misconduct, fraud, breach of fiduciary duty or breach of the Partnership Agreement, including actions brought to mitigate damages to the Partnership and the Limited Partners. The generalized phrasing and the traditional legal understanding of indemnification limit application of § 6.6(E) to claims brought by or against third parties. *See L.H. Controls*, 974 NE2d at 1048.⁴⁷

⁴⁶ The omitted language is "or any Designated Affiliate's." The Appellate Division held at the pleading stage that MCAP II, Corey, and MCAP III are not "Designated Affiliates" because "they are not alleged to have performed any services on behalf of the Partnership." *MMA Meadows*, 130 AD3d at 530. No record evidence shows otherwise.

⁴⁷ Further, Partnership Agreement §§ 6.6(E), 6.6(F), and 7.7(M) are identical to the corresponding provisions in the *Walnut* partnership agreement. This court's *sub judice* summary judgment opinion in *Walnut* noted that § 6.6(F), which hinges indemnification of ILP on certain conditions, is solely applicable to third-party actions, and notes that § 7.7(M) explicitly awards

Millrun GP does not dispute general application of § 6.6(E) to the Foreclosure Action.⁴⁸ Instead, Millrun GP renews its argument that the Limited Partners bore responsibility for that suit.⁴⁹ As discussed above, the default and Foreclosure Action were caused by Millrun GP's breaches of contract and misconduct by its affiliates, Corey and MCAP II. Thus, summary judgment as to liability is granted to plaintiffs on causes of action VIII and XIII against Millrun GP for indemnification of the Limited Partners and the Partnership for reasonable attorneys' fees, costs, and expenses incurred in defending the Foreclosure Action, prosecuting cause of action IV against MCAP III, and defending MCAP III's counterclaim in this action.

F. Cause of Action IV: Derivative Breach of Contract (the Loan Agreement and the Indenture) Against MCAP III

Plaintiffs move for partial summary judgment on MCAP III's breach of the Loan Agreement and Indenture, alleging that MCAP III unreasonably declared a default and accelerated the Series A Bonds and refused to cure the default while accepting tender of payment of default and ordinary interest. MCAP III moves on grounds that it breached no contractual obligations and that the alleged breaches did not cause legally cognizable harm to the Partnership. According to MCAP III, the agreements permitted the complained-of conduct and

attorneys' fees to a prevailing party; consequently, § 6.6(E) in *Walnut* excludes first-party fees. Here too, § 6.6(E) may also be interpreted in light of § 6.6(F) and § 7.7(M), in the manner described in the *Walnut* opinion (although that opinion applies Delaware law).

⁴⁸ Defendants do not address fees, costs, and expenses incurred by the Limited Partners and the Partnership in this action as a result of the claims by and against MCAP III.

⁴⁹ I.e., ILP's refusal to release reserves. Millrun GP also blames the default and foreclosure on BFIM's predecessor's failure to purchase the debt as originally contemplated by the parties. See Dkt. 231 (bond purchase commitment letter). In any event, the briefing cites only to their own unverified allegations. Dkt. 277 (GP Defs.' Opp. Br.) at 23. Unsubstantiated allegations are insufficient to create a genuine issue of material fact. See *Zuckerman*, 49 NY2d at 562.

gave it unfettered discretion.⁵⁰ MCAP III further argues that it reasonably declined to waive the default, and that the default could not have been cured because the default interest was never paid.

The Appellate Division found that “the loan and financing agreement, as well as the trust indenture, both of which are governed by Indiana law, indicates [sic] that MCAP III had the duty to act reasonably toward the Partnership.” *MMA Meadows*, 130 AD3d 529 at 530–31. Loan Agreement § 13.17 expressly imposes this duty: “[MCAP III] shall acknowledge in writing to the [Partnership] that (a) the [Partnership] is an intended third-party beneficiary of its duties under the Documents and (b) its duty to act reasonably towards the [Partnership].” Dkt. 186 (Loan Agreement) at 60.⁵¹ Indiana law confers standing on third-party beneficiaries to a contract to sue to enforce provisions of that contract. *Centennial Mortg., Inc. v Blumenfeld*, 745 NE2d 268, 275 (Ind Ct App 2001). MCAP III does not dispute that the Partnership was a third-party beneficiary of the Loan Agreement and Indenture. The duty to act reasonably toward the

⁵⁰ Section 13.2(b) of the Indenture and § 13.1(b) of the Loan Agreement vest MCAP III with “sole and absolute discretion” to act in accordance with the interests of the holder of the Series A Bonds in line with those bonds’ priority over the Series B Bonds. Dkt. 185 (Indenture) at 160; Dkt. 186 (Loan Agreement) at 56. Those provisions relate solely to MCAP III’s “directing the Trustee in the exercise of available remedies under this [agreement] upon the occurrence of an Event of Default.” Permitting those provisions to override MCAP III’s duty to act reasonably with respect to the Partnership would render that duty illusory. In any event, MCAP III’s refusal to itself waive the default falls outside those provisions.

⁵¹ MCAP III cites several cases that are relevant only to the *implied* covenant of good faith and fair dealing, which cannot contradict express contractual terms. *See Webb v Chase Manhattan Mortg. Corp.*, No. 2:05-CV-0548, 2008 WL 2230696, at *20 (SD Ohio May 28, 2008); *Indep. Lead Mines v Hecla Mining Co.*, 143 Idaho 22, 27 (2006); *Fleming Cos., Inc. v Thriftway Medford Lakes, Inc.*, 913 F Supp 837, 846 (DNJ 1995). While *Benton Cty. Wind Farm LLC v Duke Energy Ind., Inc.*, No. 113CV01984, 2015 WL 12559885, at *29 (S.D. Ind. Oct. 9, 2015), *rev’d and remanded*, 843 F.3d 298 (7th Cir. 2016), addressed both an express and implied duty of reasonableness, the *Benton* court determined that the conduct *was* reasonable as a matter of law. *Id.* at 28. No such determination has been made here.

Partnership, recognized by the Appellate Division, prohibited MCAP III from unreasonably exercising its rights or discretion under those agreements.

Plaintiffs nonetheless fail to show entitlement to partial summary judgment. They simply rely on the scant number of days which elapsed before a default and acceleration were declared,⁵² which is insufficient. While then-trustee BONY disagreed with Corey's haste—Faith Berning at BONY testified by affidavit that two days was “very short” to declare a default and acceleration (Dkt. 335 ¶ 6)—the trustee's reluctance to act does not establish plaintiffs' prima facie entitlement to summary judgment.⁵³

Plaintiffs also argue that MCAP III's refusal to waive the default was unreasonable because its only justification is self-interest. For a default involving loan payments, § 8.2(b)(ii) of the Indenture permitted—but did not, by itself, require—MCAP III to restore the parties to their pre-default state, so long as provision for payment (including penalties) was made satisfactory to MCAP III. Dkt. 185 (Indenture) at 42-43.⁵⁴ Ms. Berning testified that the Partnership (through Corey) tendered to the trustee \$208,197.52 on July 31, 2009 to pay debt service on the Series A Note,⁵⁵ and that BONY believed that the default had been cured by August 3, 2009. Dkt. 335 [Berning Aff.] ¶¶ 7-9; *see also* Dkt. 334 (Nelson Expert Rpt.) at 32-33 (calculating that the Partnership had made Series A Bonds debt service payments of \$18,976

⁵² Plaintiffs do not argue here that MCAP III unreasonably charged default interest in July 2009.

⁵³ Plaintiffs cite Reznick's corporate testimony that lenders often waive a technical default and work out a payment plan, but this falls short of establishing MCAP III's unreasonableness.

⁵⁴ The Loan Agreement permitted MCAP III to waive an event of default. Dkt. 186 at 49.

⁵⁵ Ordinary (i.e., non-default) debt service on the Series A Bonds was approximately \$36,218. *See* Dkt. 215 [Early Exs.] at 1120-21 (net operating income spreadsheet for the Project attached to 4/21/2009 email from Jason Remillard at Equity to Corey and others).

more than the standard rate in 2009).⁵⁶ Despite evidence of the payments, given the Partnership's ongoing financial difficulties,⁵⁷ plaintiffs fail to show that MCAP III unreasonably refused to waive the default.⁵⁸

Nor can the court grant summary judgment to MCAP III on this record. MCAP III's allegation that the Partnership was unharmed by the default is inherently inconsistent with its counterclaim for a declaration that the Partnership continues to owe default interest.⁵⁹ *See* Dkt.

⁵⁶ MCAP III's conclusory statements that no default interest was paid, made through counsel, cannot overcome a prima facie showing that debt service, plus penalties, was paid. *See Zuckerman*, 49 NY2d at 562. The court additionally notes that a BFIM email suggests only \$362 of default interest remained unpaid. Dkt. 215 [Early Exs.] at 1315 (7/30/2009 Sutton email to Haynsworth). Defendants neither object to this email as evidence, nor refute its contents.

⁵⁷ Plaintiffs do not dispute that by November 2009, the Partnership fell behind again on non-default interest payments. Plaintiffs' expert opines only that the Partnership could have paid debt service through 2013 without the Series B Bonds repayments.

⁵⁸ Plaintiffs cite an Indiana Court of Appeals decision where a mortgagee's invitation to tender full payment revoked an earlier purported acceleration of the debt because it rendered the acceleration short of the "clear and unequivocal" legal standard. *See First Fed. Sav. & Loan Ass'n of Gary v Stone*, 467 NE2d 1226, 1232 (Ind Ct App 1984). Here, plaintiffs do not allege that MCAP III's intent was unclear or equivocal. Indeed, Corey stated that MCAP III would "consider taking no additional steps if all the reserves are released to trustee so long as the A Bonds remain fully current on interest" but would not waive the default. *See* Dkt. 268 at 2 (7/20/2009 Corey email to Sutton).

⁵⁹ The cases cited by MCAP III do not support its position that claimed but unpaid default interest reflects purely speculative damages. In *Petroleum v Magellan Terminals Holdings, L.P.*, C.A. No. N12C-02-302, 2015 WL 3885947, at *12 (Del Super Ct June 23, 2015), plaintiff was never billed for a portion of the claimed damages and provided no evidence of the actual alleged payments for the remainder. Here, MCAP III claims it is owed default interest. *Essex Grp., Inc. v Nill*, 594 NE2d 503, 507 (Ind Ct App 1992), addresses only an obligation to indemnify (not at issue in cause of action IV), which does not arise unless and until the party seeking indemnity pays the claim, pays judgment thereon, or makes a settlement payment. *Lexington 360 Assocs. v First Union Nat. Bank of N.C.*, 234 AD2d 187, 192, (1st Dept 1996), found no causation of injury because the plaintiff's theory relied on faulty calculations to show that it could have avoided foreclosure when the action was filed, but for the alleged wrongdoing. Here, plaintiffs' expert reported—barring defendants' premature Series B payments and the default—the Partnership would have had sufficient funds to pay standard interest on the Series A Bonds through August 1, 2013. Dkt. 236 (Nelson Expert Rpt.) at 6 ¶ 6; *id.* at 63. Finally, *TSL (USA)*

119 (MCAP III Answer to AC) at 8. There also is an issue of material fact as to whether Corey's knowledge of his own culpable conduct contributing to the shortfall rendered it unreasonable for MCAP III—acting through Corey—to swiftly accelerate the debt and to refuse to waive the default.⁶⁰ Accordingly, both motions for summary judgment as to cause of action IV are denied.

G. Causes of Action I, II, V: Derivative Fiduciary Duty and Constructive Fraud Claims

The GP Defendants move for summary judgment on causes of action I and II (breach of fiduciary duty) and V (constructive fraud, which similarly requires a fiduciary relationship), because their fiduciary duties purportedly ran to the Bondholders, rather than the Partnership, which was allegedly insolvent at all relevant times. That theory runs contrary to Delaware law, which controls duties and rights of the general and limited partners and their affiliates not specified in the Partnership Agreement. *See Culligan Soft Water Co. v Clayton Dubilier & Rice LLC*, 118 AD3d 422, 422 (1st Dept 2014); *accord Nagy v Riblet Prods. Corp.*, 79 F3d 572, 576 (7th Cir 1996) (applying Illinois law). In a case cited by the GP Defendants, the Supreme Court of Delaware held that individual creditors of an insolvent corporation could assert a derivative claim against corporate directors for breach of fiduciary duties owed to the corporation, but had no right to assert such claims directly. *N. Am. Catholic Educ. Programming Found., Inc. v*

Inc. v OppenheimerFunds, Inc., 113 AD3d 410, (1st Dept 2014), *aff'g* 2013 NY Slip Op 30743(U), at 17-19 (Sup Ct NY County), affirmed that damages for a breach of loan contract were too speculative where the alleged breaches had not caused diminution of the collateral (comprising securities). *See* 2013 NY Slip Op 30743(U), at 17-19. Damages here are based on amounts claimed by MCAP III.

⁶⁰ Although the Appellate Division dismissed the causes of action for breach of the Partnership Agreement against nonparties to that agreement, it did not foreclose imputing Corey's knowledge and intent to MCAP III. A factfinder might also conclude that Corey unreasonably manufactured the July 2009 default to benefit MCAP III while ostensibly acting on behalf of Millrun GP (and MCAP II). The court will not address the issue any further here because the parties do not address it in their briefing.

Gheewalla, 930 A2d 92, 101-02 (Del 2007). Derivative standing accrues only because creditors “take the place of the shareholders as the residual beneficiaries of any increase in value” of an insolvent corporation, *id.* at 101 (emphasis added), not because creditors can force the fiduciaries to act against corporate interests. In rejecting direct creditor claims, the *Gheewalla* court recognized directors’ “fiduciary duty to exercise their business judgment in the **best interest of the insolvent corporation**” and that “[d]irectors of insolvent corporations must retain the freedom to engage in vigorous, good faith negotiations with individual creditors **for the benefit of the corporation.**” 930 A2d at 103 (emphasis added). Defendants cite no cases where mere insolvency extinguished fiduciary duties owed to a Delaware entity.⁶¹

As to causes of action I and II for breach of fiduciary duty, the GP Defendants argue they could not have breached their fiduciary duties because their refusal to supply further deficit funding complied with the Partnership Agreement. This argument fails because Millrun GP breached the Partnership Agreement by paying interest on the Series B Bonds and never properly

⁶¹ Indeed, if mere insolvency extinguishes fiduciary duties to the corporation, it would be impossible to assert a **derivative** claim. Defendants’ other cited cases also do not support their position. First, *Quadrant Structured Prods. Co. v Vertin*, 115 A3d 535, 547 (Del Ch 2015), followed *Gheewalla* in rejecting, despite insolvency, direct creditor claims for breach of fiduciary duty. Next, the holding of *Bren v Capital Realty Grp. Senior Hous., Inc.*, Civ. A. No. 19902-NC, 2004 WL 370214 (Del Ch Feb. 27, 2004), cited by defendants was overruled by *Gheewalla*. See *Quadrant*, 115 A3d 535 at 545-47. Moreover, the alleged duty in *Bren* was to preserve “non-operating assets,” such as legal claims, which was not at odds with duties owed to the entity. 2004 WL 370214, at *4. Finally, *UBS Real Estate Sec., Inc. v Fairmont Funding Ltd.*, 19 Misc. 3d 1123(A), at *4 (Sup Ct NY County 2008), obliges directors to manage the corporation conservatively as a trust fund for the creditors’ benefit. This “trust fund” doctrine was also rejected by *Gheewalla*. See *Quadrant*, 115 A3d at 545. Even under the “trust fund” doctrine, paying Series B Bonds interest was not conservative. Direct fiduciary duties to creditors may arise, however, upon dissolution of a corporate entity. See *Kidde Indus., Inc. v Weaver Corp.*, 593 A2d 563, 564 (Del Ch 1991), citing 8 Del. C. §§ 278, 281(b).

discharged its operating expense loan obligations or MCAP II's Operating Deficit Guaranty.⁶²

The GP Defendants' motion is denied as to causes of action I, II, and V.

H. Cause of Action VI: Derivative Gross Negligence Against MCAP II and Corey

The GP Defendants move for summary judgment on derivative cause of action VI for gross negligence against MCAP II and Corey, averring that the statute of limitations has run on conduct before 2009, including improper Partnership payments to MCAP II and Corey's affiliates and Millrun GP's failure to assert defenses to the Foreclosure Action. Plaintiffs oppose, citing MCAP II and Corey's failure to oppose MCAP III's motion for summary judgment in the Foreclosure Action in 2013. The GP Defendants argue that Millrun GP notified plaintiffs in 2009 that it would not defend the Foreclosure Action. Plaintiffs do not contest receipt of this notice or knowledge of the Foreclosure Action in 2009.

The instant action was filed on November 13, 2013. Under CPLR § 214(4), an action to recover damages for injury to property must be commenced within three years. "[T]he governing accrual rule is the usual one in tort cases: the cause of action accrued when *injury was inflicted*." *Town of Oyster Bay v Lizza Indus., Inc.*, 22 NY3d 1024, 1034 (2013) (emphasis added). As MCAP II and Corey's failure to oppose summary judgment in the Foreclosure Action *in 2013*

⁶² Also, the cases the GP Defendants cite do not support their argument that the exercise of discretion under a contract cannot breach fiduciary duties. In *Hokanson v Petty*, C. A. No. 3438-VCS, 2008 WL 5169633, at *5-6 (Del Ch Dec. 10, 2008), the court held that defendants could not have breached their fiduciary duty in structuring a contractually mandated transaction when they had "very little, if any, discretion" in so doing—indeed, discretion had been vested in a *third party*. *Id.* at *2. *Guerrand Hermes v J.P. Morgan & Co. Inc.*, 2 AD3d 235, 238 (1st Dept 2003), held that the defendant did not breach his fiduciary duties because the defendant had followed the required investment strategy, and did not breach the contract by refusing plaintiffs' directive because plaintiffs had no authority to so direct the defendant.

inflicted injury on plaintiffs, the GP Defendants fail to make a prima facie showing of entitlement to summary judgment on that aspect of cause of action VI.

The GP Defendants also contend that plaintiffs were at fault, that the GP Defendants owed duties to creditors, and that plaintiffs ultimately incurred no harm (as the foreclosure sale was canceled). Plaintiffs were unquestionably harmed by incurring unnecessary legal fees to undo the damage done by GP Defendants' abdication of their responsibilities. The remaining arguments are rejected for the same reasons stated in regard to causes of action I, II, III, V, and XII.

Defendants' motion is granted solely with respect to the alleged gross negligence of MCAP II and Corey's actions prior to November 13, 2010. The allegation in paragraph 231 of the Amended Complaint (Dkt. 48) that MCAP II and Corey were grossly negligent (in 2009) for "draining the Partnership's funds to pay their affiliated entities knowing that, in doing so, the Partnership would have insufficient funds remaining to pay the debt service on the Series A Note, which would in turn result in default interest, penalties, attorneys' fees, and acceleration," is dismissed.

I. GP Defendants' Motion as to Alleged Lack of Damages on Plaintiffs' Remaining Causes of Action

The GP Defendants move for summary judgment on all remaining claims, contending that I.P. profited while defendants lost millions in loaned funds. As discussed above, plaintiffs demonstrated harm on the causes of action on which they moved for summary judgment. Defendants do not specify how their argument applies to the remaining causes of action.

The GP Defendants more generally argue that the Partnership's present insolvency—which plaintiffs do not dispute—means that a recovery on the derivative claims would only offset the amount due the Bondholders. They maintain that the amounts owed on the bonds and

the Partnership's recovery on the derivative claims should be resolved in the Foreclosure Action. As the Appellate Division recognized, this action is more comprehensive than the Foreclosure Action, which is presently stayed in favor of this action. Accordingly, it is

ORDERED that plaintiffs' motion for partial summary judgment is granted as to cause of action X for fraud against MCAP II and Corey, causes of action III and XII for breach of contract against Millrun GP, and cause of action XI for breach of contract against MCAP II; and it is further

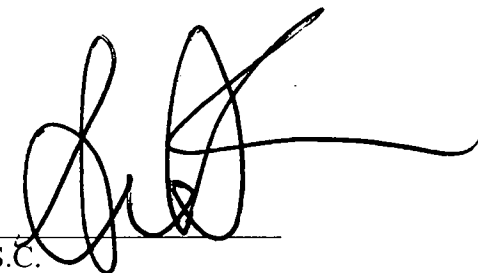
ORDERED that plaintiffs' motion for partial summary judgment as to causes of action VIII and XIII is granted as to plaintiffs' reasonable legal fees, costs, and other losses incurred in the Foreclosure Action and in defending or prosecuting claims by or against MCAP III in this action, and is otherwise denied; and it is further

ORDERED that plaintiffs' motion for partial summary judgment as to cause of action IV is denied; and it is further

ORDERED that the motion for summary judgment of defendants MCAP II and Corey is granted with respect to cause of action VI to the extent of dismissing the allegations of paragraph 231 of the Amended Complaint, and is denied as to plaintiffs' remaining allegations in cause of action VI and remaining causes of action; and it is further

ORDERED that defendant MCAP III's motion for summary judgment is denied.

Dated: March 28, 2018

ENTER: 

J.S.C.

SHIRLEY WERNER KORNREICH
J.S.C.