SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK: COMMERCIAL DIVISION PART 48

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TERRY HIBBARD, INDIVIDUALLY AND ON BEHALF OF ALL OTHERS SIMILARLY SITUATED, SUSAN BRACKEN, INDIVIDUALLY AND ON BEHALF OF ALL OTHERS SIMILARLY SITUATED, MICHAEL P. MILLER, INDIVIDUALLY AND ON BEHALF OF ALL OTHERS SIMILARLY SITUATED, JAMIE BECKETT, INDIVIDUALLY AND ON BEHALF OF ALL OTHERS SIMILARLY SITUATED, and LYNDA CALLAWAY, INDIVIDUALLY AND ON BEHALF OF ALL OTHERS SIMILARLY SITUATED,

Plaintiffs,

- v -

AMERICAN FINANCE TRUST, INC., AMERICAN FINANCE ADVISORS, LLC, AR GLOBAL INVESTMENTS, LLC, NICHOLAS SCHORSCH, WILLIAM KAHANE, EDWARD WEIL, NICHOLAS RADESCA, DAVID GONG, STANLEY PERLA, and LISA KABNICK,

Defendants.

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INDEX NO. 655339/2018

MOTION DATE

MOTION SEQ. NO. 004

DECISION + ORDER ON MOTION

HON. ANDREA MASLEY:

The following e-filed documents, listed by NYSCEF document number (Motion 004) 82, 83, 84, 85, 86, 87, 88, 89, 90, 91, 92, 93, 94, 95, 96, 97, 98, 99, 100, 101, 102

were read on this motion to/for AMEND CAPTION/PLEADINGS.

In motion sequence number 004, plaintiffs Terry Hibbard, Susan Bracken, Michael P. Miller, Jamie Beckett, Joseph Battaglia, and Lynda Callaway, individually and on behalf of others similarly situated, move, pursuant to CPLR 3025, to amend the amended complaint (AC).[1]

[1] On May 29, 2019, the parties entered into a stipulation fully consolidating this action with *Bracken, et al. v American Finance Trust, Inc., et al.*, Index No. 651348/2019 and *Callaway v American Finance Trust, Inc., et al.*, Index No. 652523/2019 under this action's Index Number. (NYSCEF Doc. No. [NYSCEF] 9, Consolidation Stipulation; NYSCEF 11, Consolidation Order.)

Procedural Background

On October 26, 2018, plaintiff Terry Hibbard commenced this action by summons and complaint as a securities class action. (NYSCEF 1, Summons and Class Action Complaint.) On October 24, 2019, Hibbard filed an amended complaint.[2] (NYSCEF 13, AC.) In the AC, plaintiffs allege that the merger of Retail Centers of America, Inc. (RCA) into American Finance Trust, Inc. (AFIN) was injurious to the shareholders of both companies.

On February 8, 2018, Carolyn St. Clair-Hibbard, wife of Terry Hibbard, filed a class action in the U.S. District Court, Southern District of New York against AFIN, American Finance Advisors, LLC, AR Global Investments, LLC, Nicholas Schorsch, and William D. Kahane asserting claims for violations of Sections 14(a), 20(a), and 20(b) of the Federal Securities Exchange Act as well as breach of fiduciary duty and aiding and abetting that breach (SDNY Action). (*St. Clair-Hibbard v American Fin. Trust, Inc.*, 2019 WL 4601720, *3, 2019 US Dist LEXIS 162075, *7 [SD NY, Sept. 23, 2019], *affd* 812 Fed Appx 36 [2d Cir, May 5, 2020]; *see also* NYSCEF 102, SDNY Opinion and Order at 5.) On February 23, 2018, St. Clair-Hibbard filed an amended complaint repleading her federal claims in an individual capacity and not as a class. (*Id.*) On May 25, 2018, St. Clair-Hibbard filed a second amended complaint adding additional allegations asserting misleading information in the proxy materials distributed (SDNY SAC). (*Id.*; NYSCEF 102, SDNY Opinion and Order at 6; *See also* 44, SDNY SAC.) On September 23, 2019, U.S District Court Judge Lorna G. Schofield dismissed St. Clair-Hibbard's second

[2] The FAC was filed prior to the County Clerk effectuating the consolidation of the three actions. (*See* NYSCEF 20, 21, County Clerk Certification of Minutes.)

amended complaint; the U.S. Court of Appeals, Second Circuit affirmed that decision. (*St. Clair-Hibbard v American Fin. Trust, Inc.*, 2019 WL 4601720, 2019 US Dist LEXIS 162075 [SD NY, Sept. 23, 2019,], *affd* 812 Fed Appx 36 [2d Cir, May 5, 2020].)

Factual Background

AFIN is a real estate investment trust (REIT) organized to acquire and operate single tenant retail properties net leased to creditworthy tenants. (NYSCEF 13, AC ¶¶2, 36.) In 2017, RCA, another REIT, merged into AFIN. (*Id.* ¶13.) Prior to this merger, both RCA and AFIN were managed by defendant AR Global Investments, LLC (AR Global) and affiliates. (*Id.* ¶3.) Defendants Kahane and Schorsch own and control AR Global, which in turn controls defendant American Finance Advisors, LLC (AF Advisors). (*Id.* ¶¶14-15.) Since its formation in 2013, AFIN has had no employees and has been externally managed by AF Advisors, pursuant to an Advisory Agreement dated April 1, 2013, amended in mid-2015 (2nd Advisory Agreement) and again as part of the merger (3rd Advisory Agreement). (*Id.* ¶¶12, 14.) Pursuant to these Advisory Agreements, AF Advisors provided all of AFIN's operational, managerial, and financial services. (*Id.* ¶37.)

Plaintiffs allege Schorsch, Kahane, and AR Global embarked on a scheme to prevent AFIN, RCA, and other AR Global controlled REITs from terminating their advisory agreements. (*Id.* ¶8.) According to plaintiffs, AR Global wanted "to lock in enormous advisor fees for the next 20 years by saddling [AFIN and other REITs] with excessive termination fees (so-called "internalization fees") to ensure that the REITs . . . would not terminate the Advisory Agreements and ensure that AR Global could reap a huge windfall if AFIN decided to become self-managed." (*Id.* ¶53.) This was

accomplished by merging REITs with one-year advisory agreements, like RCA, into REITs with 20-year advisory agreements with AR Global owned advisory companies. (*Id.* ¶8.) Once the merger of RCA into AFIN was approved, the 3rd Advisory Agreement was implemented, replacing RCA's one-year advisory agreement. (*Id.* ¶¶3, 56.)

It is alleged that the merger and the related changes to the advisory agreement between AFIN and AF Advisors were intentionally designed to enrich defendants at the expense of AFIN and RCA. (*Id.* ¶¶46-50.) Before the merger, RCA could terminate its advisory agreement with minimal financial payment to its advisor. (*Id.* ¶54.) However, pursuant to the 3rd Advisory Agreement, if AFIN terminated, it had to pay excessive termination or "internalization fees." (*Id.* ¶53.) Under the 3rd Advisory Agreement, the internalization fee became "approximately five to six times over AFIN's annual average operating income from 2012 to 2016, and constitute[d] over 10% of AFIN's pre-merger stockholder equity and around 8% of AFIN's equity post-merger." (*St. Clair-Hibbard*, 2019 WL 4601720, *2, 2019 US Dist LEXIS 162075, *5-6.) If AFIN decided to internalize management, it had to give a one-year advance notice to AF Advisors, and if it sought internalization in connection with a takeover by an outside company, the acquirer would have to pay AFIN the advisory fee that would have been payable for one year after a vote to terminate the 3rd Advisory Agreement. (*Id.*) The internalization fee, as outlined in the 3rd Advisory Agreement, is estimated to cost AFIN over $125 million. (*Id.*) It is alleged that the purpose of the excessive termination fee is to prevent AFIN from ever disassociating from AF Advisors and to ensure that AR Global would reap a huge windfall if AFIN ever decided to become self-managed. (NYSCEF 13, AC ¶53.)

Plaintiffs allege that shareholder approval of the merger and the accompanying effectuation of the 3rd Advisory Agreement was obtained by defective proxy statements that failed to disclose material facts concerning the adverse impact of the agreement. (*Id.* ¶¶57-90.) The merger and the 3rd Advisory Agreement allegedly brought about a plunge in the market price of AFIN, a material discount in its net asset value (NAV), and a reduction in the dividend. (*Id.* ¶¶91-94.) Plaintiff alleges that the merger and the 3rd Advisory Agreement enabled defendants to wrongly take tens of millions of dollars from AFIN in the form of fees and other payments.

The Proposed Amended Complaint (PAC), AC, and SDNY SAC

In the AC, plaintiffs allege claims for violations of the Securities Act of 1933 (NYSCEF 13, AC), while the SDNY SAC contained direct claims for violations of the Securities Exchange Act of 1934 (Exchange Act), as well as derivative claims for breach of fiduciary duty and aiding and abetting such conduct. (NYSCEF 44, SAC.) The PAC contains shareholder derivative claims for breaches of fiduciary duties, waste of assets, aiding and abetting the breaches of fiduciary duties, unjust enrichment, breach of duties under the RCA Charter, and breach of the RCA Charter. (NYSCEF 85, PAC.)

The PAC also contains substantially more information than the AC and the SDNY SAC about the conflicts of interest of the defendant directors, all but one of whom serves or has served on the board of AR Global, on the boards of REITs sponsored/controlled by AR Global, and/or on the boards of other entities affiliated with AR Global. (*Id.*) The AC and SDNY SAC focus more on the alleged false and misleading statements in the proxy materials and registration statements. (NYSCEF 13, AC ¶¶57-90; NYSCEF 44, SDNY SAC ¶¶68-91.) In the PAC, plaintiff does not allege

false statements or fraud, but rather, self-dealing by the directors. (NYSCEF 85, PAC.) Further, plaintiffs allege that the amendments to the AFIN Advisory Agreement, as embodied in the 3rd Advisory Agreement, were not submitted to a vote by the RCA and AFIN shareholders. (*Id.* ¶138.)

In addition to these new claims, plaintiffs seek to add St. Clair-Hibbard as a named plaintiff and omit and add defendants. The original individual defendants were Schorsch, Kahane, Edward M. Weil, Jr., Nicholas Radesca, David Gong, Stanley R. Perla, and Lisa D. Kabnick. (NYSCEF 13, AC.) All except Schorsch and Kahane were AFIN directors at the time of the merger. (*Id.* ¶¶15-22.) Plaintiffs seek to omit Kahane and Radesca and add Leslie D. Michelson and Edward G. Rendell as defendants. (NYSCEF 85, PAC.) Plaintiffs allege that Weil, Michelson, Rendell, Perla, Gong[3], and Kabnick were/are AFIN directors when the PAC was filed. (*Id.* ¶¶25-28.) AR Global and AF Advisors are defendants in both the AC and also in the PAC. AFIN's original status changed from that of defendant to nominal defendant in the PAC. (*Id.* ¶19.)

Federal Decisions

The District Court dismissed the SDNY Action pursuant to Rule 12 (b)(6). "To survive a motion to dismiss under Rule 12 (b) (6), a complaint must contain sufficient factual matter, accepted as true, to state a claim to relief that is plausible on its face." (*St. Clair-Hibbard*, 2019 WL 4601720, *3, 2019 US Dist LEXIS 162075, *8 [internal citations and quotation marks omitted].) Regarding the claim that defendants violated § 14(a) of the Exchange Act (15 USC § 78n [a] [1]) and Rule 14a-9 (17 CFR § 240.14a–9)

[3] Plaintiffs allege that Gong is a "lead independent director" of AFIN. (NYSCEF 85, PAC ¶29.)

by making false and misleading statements in proxy materials, the District Court found that "although Plaintiff alleges facts and risks about the merger and the accompanying advisory arrangement that might have caused a reasonable shareholder not to approve the transaction, the proxy statement contains extensive disclosures about those facts and risks and the shareholders did approve the transaction." (2019 WL 4601720, *4, 2019 US Dist LEXIS 162075, *9-10.) As the SDNY SAC failed to state a claim for the primary violation of deception, it stated no claim under § 20(a) of the Exchange Act (15 USC § 78t) for control person liability. (2019 WL 4601720, *7, 2019 US Dist LEXIS 162075, *19.)

The District Court also addressed the 3rd Advisory Agreement's increased internalization fees and the annual fixed and variable fees that AFIN pays to AF Advisors. (2019 WL 4601720, *2, 2019 US Dist LEXIS 162075, *5-6.) The Court stated that all of the contractual terms pertaining to internalization fees were contained in the 3rd Advisory Agreement, which was annexed to the proxy statement. (2019 WL 4601720, *5, 2019 US Dist LEXIS 162075, *4.)

> "These statements adequately disclose that the internalization fee would be extremely high and would be paid to AF Advisors, which the proxy statement discloses is a wholly owned subsidiary of AR Global. The proxy statement expressly warns that the internalization provisions could harm AFIN's ability to undertake an actual internalization (i.e., terminate AF Advisors) and to attract any third-party to acquire AFIN. Implicit, but clear, from these disclosures is that the internalization provisions in the Third Agreement reduced the value of AFIN's shares."

(*Id.* at 2019 WL 4601720, *6, 2019 US Dist LEXIS 162075, *15-16.) The District Court noted that the proxy materials contained multiple references to the 3rd Advisory Agreement provision regarding the internalization fee that AFIN would have to pay AF Advisors. (2019 WL 4601720, *6, 2019 US Dist LEXIS 162075, *14-16.) The materials

included the formula to calculate the internalization fee three times: first, in a summary of the 3rd Advisory Agreement (with some paraphrasing to make it more understandable); second, in a detailed description of how the internalization mechanism and fee were first proposed and then negotiated (again paraphrasing what became the basic terms of the fee); and third, in a discussion about conflicts of interest. The formula is repeated again in the notes to the financial statements appended to the proxy statement under the heading "Related Party Agreements Executed in Connection with the Mergers." (2019 WL 4601720, *5, 2019 US Dist LEXIS 162075, *14-15.)

The District Court's discussion on conflicts of interest was limited to AF Advisors' conflict between its own interest and the interest of shareholders. (2019 WL 4601720, *2, 5, 2019 US Dist LEXIS 162075, *4, 14.) The proxy materials acknowledged that the external management structure created conflicts on the part of AF Advisors that could result in decisions that were not in the best interest of the shareholders. (*Id.*) The District Court determined that plaintiff failed to allege that AF Advisors breached a fiduciary duty. (2019 WL 4601720, *8, 2019 US Dist LEXIS 162075, *20.) The Court noted that the 3rd Advisory Agreement and other advisory contracts stated that AF Advisors' fiduciary duty was connected to its services for AFIN. (*Id.*) In the SDNY Action, plaintiff did not allege that AF Advisors breached its fiduciary duty by not performing those services, but rather that AF Advisors breached the duty by negotiating advisory contracts, including the 3rd Advisory Agreement, that were unfair to AFIN. (*Id.*) The Court held that "[t]he contracts do not impose a duty on AF Advisors that pre-dates the creation of the contracts, specifically the duty to create a contract with the least desirable terms for AF Advisors." (*Id.*)

Although the SDNY SAC contained direct, not derivative claims, the District Court stated that "an additional basis for dismissal is that Plaintiff and the purported class lack standing to pursue these breach of fiduciary duty claims as derivative claims, having neither made a demand on AFIN's Board nor adequately alleged demand futility." (2019 WL 4601720, *8, 2019 US Dist LEXIS 162075, *23.) The Second Circuit affirmed, stating that "both the nature of Plaintiff's alleged injury and her proposed remedy demonstrate that her breach of fiduciary duty claim is derivative, which forecloses her from proceeding directly against" AF Advisors. (*St. Clair-Hibbard v Am. Fin. Tr., Inc.*, 812 Fed Appx 36, 40 [2d Cir 2020].)

Discussion

Governing Law

"New York choice-of-law rules provide that substantive issues such as issues of corporate governance, including the threshold demand issue, are governed by the law of the state in which the corporation is chartered." (*Lerner v Prince*, 119 AD3d 122, 128 [1st Dept 2014] [citation omitted].) While there is apparently a New York choice-of-law provision in the 3rd Advisory Agreement[4], there are no breach of contract claims arising from that Agreement requiring the application of New York law.

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[4] The Second Circuit noted that, although the 3rd Agreement provided that it should be construed according to New York law "'without regard to the principles of conflicts of law,'" the law of AFIN's state of incorporation, Maryland, applied because standing is governed by the laws of the state of incorporation and not by a contractual choice-of-law provision. (*St. Clair-Hibbard*, 812 Fed Appx at 39 n 1.) This court was not provided with a copy of the 3rd Advisory Agreement. However, the 2nd Advisory Agreement provides that "[t]he provisions of this Agreement shall be construed and interpreted in accordance with the laws of the State of New York as at the time in effect, without regard to the principles of conflicts of laws thereof." (NYSCEF 89, 2nd Advisory Agreement at 41, ¶25.) Assuming the language is the same in the 3rd Advisory Agreement, this provision does not extend the application of New York law to claims beyond the Agreement itself.

The Maryland law on interested director transactions, Maryland Code, Corporations and Associations (CA) § 2-419, was modeled after statutes of other jurisdictions, including Delaware, California, and New York. (*Shapiro v Greenfield*, 136 Md App 1, 20, 764 A2d 270, 280 [2000].) "Maryland courts often look to Delaware law for guidance on issues of corporate law." (*Oliveira v Sugarman,* 226 Md App 524, 538 n 10, 130 A3d 1085 [2016], *affd* 451 Md 208, 152 A3d 728 [2017]; *see also Shenker v Laureate Educ., Inc.*, 411 Md 317, 338 n 14, 983 A2d 408 [2009].) Therefore, matters of substantive law are governed by Maryland, and where applicable, Delaware law; procedural matters are governed by New York law. (*Matter of Frankel v Citicorp Ins. Servs., Inc.*, 80 AD3d 280, 285 [2d Dept 2010] [holding that "matters of procedure are governed by the law of the forum" and "matters of substantive law fall within the course charted by choice of law analysis."].)

Motion to Amend Standard

Leave to amend a pleading is freely granted absent prejudice or surprise resulting directly from any delay in asserting the proffered claim. (CPLR 3025 [b]; *McCaskey, Davies & Assoc. v New York City Health & Hosps. Corp.*, 59 NY2d 755, 757 [1983].) Leave to amend will be granted "unless the proposed amendment is palpably insufficient or patently devoid of merit." (*Lucido v Mancuso*, 49 AD3d 220, 222 [2d Dept 2008].) The proponent of the amendment must establish a prima facie cause of action by alleging facts that are congruent with the legal theory in the amendment: that is, the amended complaint must contain legally sufficient causes of action. (*Daniels v Empire-*

Further, the parties rely on Maryland and Delaware law and, thus, have waived any application of New York law even if the choice-of-law provision was triggered.

Orr, Inc., 151 AD2d 370, 371 [1st Dept 1989].) Leave to add parties will be granted, provided a cognizable cause of action is pleaded against the proposed parties and there is no surprise or prejudice. (*see Global Liberty Ins. Co. v Tyrell,* 172 AD3d 499, 500 [1st Dept 2019].)

Defendants oppose the motion on the grounds of issue and claim preclusion, failure to allege demand futility, shareholder ratification, and failure to state any cause of action.

Res Judicata and Collateral Estoppel

Under res judicata or claim preclusion, a final judgment bars future actions between the same parties on the same cause of action. (*Parker v Blauvelt Volunteer Fire Co.*, 93 NY2d 343, 347 [1999].) "[O]nce a claim is brought to a final conclusion, all other claims arising out of the same transaction or series of transactions are barred, even if based upon different theories or if seeking a different remedy." (*Id.* [internal quotation marks and citation omitted].) The doctrine of res judicata applies to issues of fact and law necessarily decided and to claims that were not litigated in the prior action but that could have been litigated at that time. (*Gramatan Home Invs. Corp. v Lopez,* 46 NY2d 481, 485 [1979].) A necessarily decided finding means that the finding was necessary to arrive at the final judgment. (*Zabriskie v Zoloto*, 22 AD2d 620, 624 [1st Dept 1965].)

Collateral estoppel or issue preclusion bars re-litigation of an issue when (1) the identical issue was decided in the prior action and is decisive in the present action, and (2) the party to be precluded from relitigating the issue had a full and fair opportunity to contest the prior issue, and the issue was necessarily determined. (*Kaufman v Eli Lilly*

& Co., 65 NY2d 449, 455 [1985]; *233233 Co. v City of New York,* 171 AD2d 492, 496 [1st Dept 1991].) "The doctrine of collateral estoppel, a narrower species of res judicata," applies to an issue clearly raised in a prior action and decided against the party sought to be precluded or those in privity with that party. (*Ryan v New York Telephone Co.*, 62 NY2d 494, 500 [1984].)

The District Court's decision does not preclude the derivative claims in the PAC. The claims in the SDNY Action were not presented as derivative, and the dismissal of an action pleading direct shareholder claims does not prevent the same parties from subsequently bringing a derivative action. (*See Tong v Hang Seng Bank*, 210 AD2d 99, 100 [1st Dept 1994].) Further, unlike the SDNY SAC, the PAC does not contain allegations of false statements or violations of securities laws. Although the District Court found that plaintiff lacked standing to pursue the breach of fiduciary claims derivatively as an additional basis to dismiss those claims, the Court's determination that plaintiff failed to plead demand futility was not necessary to arrive at the final judgment in that action particularly where the claims were plead as direct. The failure to show demand futility was not the reason that the SDNY Action was dismissed. Therefore, the court rejects defendants' argument.

Demand Futility

Before bringing a derivative action, a shareholder must make a good faith effort to persuade the corporation to take action to remedy the complained of harm. If the shareholder sues without demanding that the corporation take corrective action, he or she must explain to the court why demand should be excused. (*Werbowsky v Collomb,* 362 Md 581, 600-601, 766 A2d 123, 133-134 [Md App 2001].) In the PAC, plaintiffs

allege that demand would have been futile, because the directors are conflicted, motivated by self-interest, and controlled and dominated by Schorsch, Weil, and AR Global, and would never have agreed to take any steps to protect AFIN. (NYSCEF 85, PAC ¶¶2-8.)

Demand is excused as futile when the plaintiff demonstrates that "a majority of the directors are so personally and directly conflicted or committed to the decision in dispute that they cannot reasonably be expected to respond to a demand in good faith and within the ambit of the business judgment rule." (*Oliveira v Sugarman,* 451 Md 208, 229, 152 A3d 728, 741 [Md 2016], quoting *Werbowsky,* 362 Md at 620, 766 A2d at 144.) An interested director is one who appears on both sides of a transaction or who expects to derive personal financial benefit from the transaction, as opposed to a benefit which devolves upon the corporation or all stockholders generally. (*Oliviera*, 451 Md at 224, 152 A3d at 728; *see In re Marriott Intl., Inc., Customer Data Sec. Breach Litig.*, 2021 WL 2401641, *10 [D Md, June 11, 2021].) "A director's interest may be shown by demonstrating a potential personal benefit or detriment to the director as a result of the decision." (*Beam v Stewart,* 845 A2d 1040, 1049 [Del 2004].)

Allegations supporting a reasonable inference that a director is so beholden to an interested party that his or her "'discretion would be sterilized'" establish a reasonable doubt as to the director's independence. (*In re USG Corp. Stockholder Litig.*, 2020 WL 5126671, *23 [Del Ch, Aug. 31, 2020], quoting *Rales v Blasband,* 634 A2d 927, 936 [Del 1993]; *see Security Police & Fire Professionals of Am. Retirement Fund v Mack*, 93 AD3d 562, 563 [1st Dept 2012].) Even when a director does not personally benefit from the transaction, but because of that director's relationship to a party interested in the

transaction, it would reasonably be expected that the director's exercise of independent judgment would be compromised, that director will be deemed interested. (*Shapiro,* 136 Md App at 24, 764 A2d at 282.) Further, when a director has an interest in both sides of a transaction, the director is not disinterested for purposes of establishing demand futility. (*Werbowsky*, 362 Md at 620, 766 A2d at 144; Shareholder Deriv. Actions L. & Prac. § 5:13 [Westlaw].) A relationship that renders a director unable to consider a demand impartially "without being influenced by the … personal consequences resulting from the decision" may establish demand futility. (*Beam*, 845 A2d at 1050 [internal quotation marks and citation omitted].)

The focus of demand futility is on the entire board rather than only on the directors who approved the decisions at issue (*Calma v Templeton,* 114 A3d 563, 576 [Del Ch 2015]) and on the board as constituted at the time that the complaint or amended complaint is filed. (*See Serafin v Schorsch,* 2015 WL 3901646, *3, [SDNY, June 24, 2015] [applying Maryland law]; *In re iNFOUSA, Inc. Shareholders Litig.,* 953 A2d 963, 986-987 [Del Ch 2007].) Here, the operative date for determining the futility issue is the date that the PAC was filed, July 20, 2020.

In the PAC, plaintiffs allege that defendant Schorsch is the Chair and CEO of AR Global, and the controlling owner by virtue of his 56.02% ownership. (NYSCEF 85, PAC ¶23.) His wife owns 7.54% of AR Global. (*Id.*) AR Global owns 100% of AFIN's and RCA's advisors and property managers, post and pre-merger. (*Id.*) Schorsch is not on AFIN's board, but he allegedly dominates those who are, as he controls who may be on AFIN's board or the boards of AR Global related companies. (*Id.* ¶24.)

Defendant Weil has been the CEO, President, and Chair of AFIN and AR Global since 2015, and owns 3.51% of AR Global. (*Id.* ¶25.) Weil is director of five other AR Global managed REITs and formerly served on the board of five other AR Global managed REITs and worked as an executive officer of at least eleven AR Global managed REITs. (*Id.*) During most of his tenure at AR Global entities, Weil reported to Schorsch and has been working for Schorsch since at least 2004. (*Id.*) Before the merger, Weil was RCA's CEO, President, and Chair. (*Id.*) Schorsch and Weil are controlling persons of AR Global. (*Id.* ¶¶23-25.)

Defendant Rendell became an AFIN director after the merger. (*Id.* ¶26.) Before that, he served as an RCA director for more than two years. (*Id.*) Schorsch was also an RCA director at that time. (*Id.*) Rendell serves as director of three additional AR Global managed REITs and an investment company managed by AR Global. (*Id.*) He previously served as director on five AR Global affiliated entities. (*Id.*) "Since 2009, he has sat on the Boards or been a trustee of twelve AR Global entities." (*Id.*) Rendell has received $2.4 million for his services as director of AR Global managed entities over the last four years, including more than $1.2 million in stock awards. (*Id.*) His annual income of $500,000 from AR Global entities controlled by Schorsch is believed to be a material part of his income. (*Id.*)

Defendant Michelson became an AFIN director after the merger. (*Id.* ¶27.) Previously he served on the RCA board with Schorsch. (*Id.*) Michelson is director of two additional AR Global managed REITs and trustee of an AR Global affiliate. (*Id.*) "Michelson previously served on the boards of at least 10 other AR Global-managed REITs… ." (*Id.*) At several of these companies, he served with Schorsch. (*Id.*)

Michelson has received at least $2.2 million, including at least $945,000 in stock awards, for his service as a director of AR Global-managed and AR Capital-managed entities over the past four years. (*Id.*) Michelson's annual income from AR Global entities of approximately $500,000 per year is believed to a material portion of his active income. (*Id.*)

Further, none of the defendants, including the directors, hold any significant amount of AFIN stock, and therefore, have almost no financial stake in AFIN. (*Id.* ¶34.) It is also alleged that Rendell and Michelson were also on the RCA Board that approved the elimination of RCA Charter protections for shareholders that could have carried over post-merger. (*Id.* ¶28.) All of these allegations are enough to show that Weil, Rendell, and Michelson, who constitute a majority of the five person AFIN board, are so conflicted that they cannot respond to a demand on the basis of AFIN's interest.

Although courts evaluating demand futility are "clear that interest or dependence may not be found merely from the fact that directors are paid for their services or on speculative, non-specific allegations that they acted in order to secure their retention as directors." (*Werbowsky*, 362 Md at 610, 766 A2d at 139; *Trasatti v Trasatti,* 2018 WL 2750266, *11, [Md Ct Spec App 2018]; *Oliviera*, 226 Md App at 544, 130 A3d at 1097), here it is alleged that the directors received compensation from two boards with opposing interests.

Further, while the District Court found that certain directors who approved the 2017 merger and the 3rd Advisory Agreement were not interested, this finding is irrelevant. The analysis here requires an examination of the members of the board in

July 2020 when the PAC was filed and not the board which voted on the merger in 2016/2017 or the board at the time the SDNY SAC was filed.

While boards of directors are protected by the business judgment rule, which is the presumption that directors make business decisions in good faith and in the belief that the decision is in the best interest of the company (CA § 2-405.1; *Werbowsky,* 362 Md at 608-609, 766 A2d at 138), plaintiffs have sufficiently alleged enough to question whether the rule applies here. (*Werbowsky*, 362 Md at 610, 766 A2d at 139; *see Scalisi v Fund Asset Mgt., L.P.,* 380 F3d 133, 141 [2d Cir 2004]; *Boland v Boland*, 423 Md 296, 331, 31 A3d 529, 550 n 25 [2011].) Long standing remunerative business relationships between Schorsch, AR Global, and a majority of AFIN directors are alleged. It is alleged that Schorsch has for many years dominated and controlled AR Global and that he controls appointments to the board of AFIN and other companies. Plaintiffs also sufficiently allege that a majority of the directors would not take steps adverse to AR Global that might endanger their own benefits resulting from serving on AR Global related boards. Therefore, defendants' argument is rejected on this basis.

Director and Shareholder Approval

CA § 2-419, Maryland's interested director statute, provides in relevant part,

> "(a) If subsection (b) of this section is complied with, a contract or other transaction between a corporation and any of its directors or between a corporation and any other corporation, firm, or other entity in which any of its directors is a director or has a material financial interest is not void or voidable solely because of any one or more of the following:
> (1) The common directorship or interest;
> (2) The presence of the director at the meeting of the board or a committee of the board which authorizes, approves, or ratifies the contract or transaction; or
> (3) The counting of the vote of the director for the authorization, approval, or ratification of the contract or transaction.

> (b) Subsection (a) of this section applies if:
> (1) The fact of the common directorship or interest is disclosed or known to:
> (i) The board of directors or the committee, and the board or committee authorizes, approves, or ratifies the contract or transaction by the affirmative vote of a majority of disinterested directors, even if the disinterested directors constitute less than a quorum; or
> (ii) The stockholders entitled to vote, and the contract or transaction is authorized, approved, or ratified by a majority of the votes cast by the stockholders entitled to vote other than the votes of shares owned of record or beneficially by the interested director or corporation, firm, or other entity; or
> (2) The contract or transaction is fair and reasonable to the corporation."

Under section (b), a transaction is not void because a director is interested, if the transaction is approved by a majority of the disinterested directors, or approved by a majority of disinterested shareholders, or is fair to the corporation at the time that the transaction is approved or ratified. Thus, under this statute, an interested director transaction can still be approved by a neutral decision-making body. (*Shapiro,* 136 Md App 1, 23, 764 A2d 270, 282.)

Defendants assert that plaintiffs' claims are barred because the RCA and AFIN shareholders' votes ratified the merger. In response, plaintiffs argue that, in the PAC, they allege that the 3rd Advisory Agreement was not submitted to a vote by the shareholders (NYSCEF 85, PAC ¶138), and thus, CA § 2-419(b)(1)(ii) does not apply here. However, this allegation is directly contradicted by the December 16, 2016 Joint Proxy Statement mailed to RCA and AFIN's shareholders (NYSCEF 88, Joint Proxy Statement) and AFIN's February 14, 2017 8-K Form. (NYSCEF 92, AFIN's 2/14/2017 Form 8-K.)

The Joint Proxy clearly explains the differences between the AFIN and RCA Advisory Agreements and that the 3rd Advisory Agreement would become effective upon the closing of the merger, which would occur after the shareholders' votes:

> "The term of the AFIN Advisory Agreement is longer than that of the RCA Advisory Agreement. The RCA Advisory Agreement has a one-year renewable term unless terminated by either party upon 60 days' notice without cause or penalty. The AFIN Advisory Agreement has a term that does not expire until April 29, 2035 and thereupon renews automatically for consecutive 20-year terms, unless terminated (1) in connection with the right of AFIN (*which right is contained in amendments to the AFIN Advisory Agreement that will become effective only upon closing of the merger)* to internalize the services provided under the AFIN Advisory Agreement after January 1, 2018 with payment of a specified internalization fee or (2) (a) by the independent directors of AFIN or by the AFIN Advisor with cause (as defined in the AFIN Advisory Agreement) upon 45 days' notice, (b) by the AFIN Advisor for good reason (as defined in the AFIN Advisory Agreement) upon 60 days' notice or (c) by the AFIN Advisor upon a change of control (as defined in the AFIN Advisory Agreement) upon 60 days' notice."

(*Id.* at 23-24 [emphasis added].) It also clearly states that, when the merger agreement was signed on September 6, 2016, RCA entered into a side agreement providing for termination of the RCA Advisory Agreement when the merger becomes effective and when AFIN signed the merger agreement, it entered into the 3rd Advisory Agreement which would come into effect upon the merger. (*Id.* at 29, 35.) Both the September 6, 2016 merger agreement and the 3rd Advisory Agreement were annexed as exhibits to the Joint Proxy. (*Id.* at exs. A and E.)

Although plaintiffs allege that the 3rd Advisory Agreement was withheld from a "separate shareholder vote" (*see* NYSCEF 85, PAC ¶169), they fail to present any law requiring that this Agreement be voted on separately from the merger. The 3rd Advisory Agreement, as evidenced by the Joint Proxy Statement, was clearly part of the merger

vote. The shareholders voted, and thus, these transactions were ratified by those shareholders' votes. (*See* NYSCEF 92, AFIN's 2/14/2017 Form 8-K.)

Further, the Joint Proxy informed the shareholders of potential conflicts including that

> "• Edward M. Weil, Jr. is the chief executive officer, president and chairman of the board of directors of both AFIN and RCA and is also the chief executive officer of AR Global, which is the parent of (1) the AFIN Special Limited Partner, the direct owner of the AFIN Advisor and the AFIN Property Manager, and (2) the RCA Sponsor, which is the parent of the RCA Special Limited Partner, the direct owner of the RCA Advisor.
>
> • One of AFIN independent directors currently serves as an independent director on the board of directors of another AR Global-sponsored REIT. Stanley R. Perla, a director of AFIN, has also served as an independent director of American Realty Capital Hospitality Trust, Inc. since January 2014. In addition, since October 2014, David Gong has served as an independent director of AR Capital Acquisition Corp. (currently known as Axar Acquisition Corp.), or AXAR, an entity sponsored by AR Capital until October 2016, when AXAR's shareholders approved, among other things, the transactions whereby Axar Capital Management became AXAR's new sponsor.
>
> • RCA's independent directors currently serve as independent directors on the board of directors of certain other AR Global sponsored REITs. Leslie D. Michelson, a director of RCA, has also served as an independent director of Healthcare Trust, Inc. since December 2015, and Business Development Corporation of America II since August 2014. Governor Edward G. Rendell, a director of RCA, has served as an independent director of Global Net Lease, Inc. since March 2012, Healthcare Trust, Inc. since December 2015, and Business Development Corporation of America II since August 2014. In addition, Mr. Michelson and Governor Rendell have served as directors of Business Development Corporation of America since January 2011, an entity advised by AR Global until November 2016, when BDCA's external advisor was acquired by Benefit Street, L.L.C.
>
> • Pursuant to the merger agreement, immediately following the effective time of the merger, AFIN has agreed to increase the size of the AFIN Board from four to six directors and elect Leslie D. Michelson and Governor Edward G. Rendell, both currently directors of RCA, to serve as directors of AFIN. AFIN also expects Kase Abusharkh, RCA's current chief

> investment officer, to serve as chief investment officer of the multi-tenant portfolio of the combined company. See "Management of AFIN — Compensation of Compensation of Executive Officers and Directors of AFIN and the Combined Company" beginning on page 187.
>
> • After the merger, affiliates of AR Global will continue to act as an advisor to AFIN and other AR Global-sponsored REITs. GNL, another AR Global-sponsored REIT, also invests in in net leased commercial properties and has entered into a merger agreement with Global II, which has similar objectives to AFIN and GNL. These entities may compete with the combined company for investment, tenant and financing opportunities."

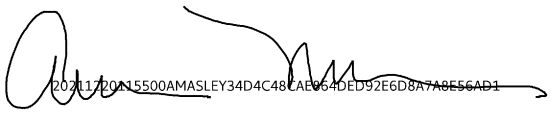
(NYSCEF 88, Joint Proxy Statement at 149.) The Joint Proxy also pointed out the "negative factor" of the 20-year term of the AFIN Advisory Agreement when analyzing "the merger and other transactions contemplated thereby." (*Id.* at 17, 127.) Thus, the interests, as well as the negatives of the merger, were disclosed. (CA § 2-419[b][1].)

Finally, plaintiffs withdraw their claim for breach of the RCA Charter. (NYSCEF 101, Plaintiffs' Reply Memo, Point VII, E.) As to the other claims involving the amendment to the RCA Charter, those too are barred by CA § 2-419(b), as the RCA shareholders also voted on the amendment. "At RCA's special meeting, RCA stockholders will be asked to vote first, on a proposal to amend RCA's charter, which we refer to as the RCA Charter Amendment, to remove certain provisions (including the right to seek an appraisal of RCA's assets) that would otherwise impose restrictions and other substantive provisions on the transactions contemplated by the merger agreement. Second, the RCA stockholders will be asked to vote on proposals to approve the company merger and to adjourn the special meeting." (NYSCEF 88, Joint Proxy at 2-3.) A joint press release confirms the special meeting was held and the merger was approved by RCA's shareholder. (NYSCEF 92, AFIN's 2/14/2017 Form 8-K at 6.)

Plaintiffs have withdrawn their 1933 Act claims in light of the Second Circuit's decision, leaving no claims in the operative complaint. (NYSCEF 77, Plaintiffs' May 29, 2020 Letter.)

Accordingly, it is

ORDERED that plaintiffs' motion for leave to amend the amended complaint is denied and the case is dismissed.



12/20/2021
DATE

ANDREA MASLEY, J.S.C.

CHECK ONE:	x	CASE DISPOSED			NON-FINAL DISPOSITION		
		GRANTED	X	DENIED	GRANTED IN PART		OTHER
APPLICATION:		SETTLE ORDER			SUBMIT ORDER		
CHECK IF APPROPRIATE:		INCLUDES TRANSFER/REASSIGN			FIDUCIARY APPOINTMENT		REFERENCE