IN THE COURT OF CHANCERY OF THE STATE OF DELAWARE

ROSS HOLDING AND MANAGEMENT COMPANY; ELD PARTNERS, L.P.; GREGORY N. SENKEVITCH; NICHOLAS G. STATHAKIS; and GARY J. SOPKO,	:	
Plaintiffs,	:	
v.	:	**C.A. No. 4113-VCN**
ADVANCE REALTY GROUP, LLC; ADVANCE CAPITAL PARTNERS, LLC; ADVANCE REALTY DEVELOPMENT, LLC; PETER COCOZIELLO; ROTHSCHILD REALTY, INC.; ROTHSCHILD REALTY MANAGERS, LLC; FIVE ARROWS REALTY SECURITIES, III, LLC; D. PIKE ALOIAN; JOHN MCGURK; KURT R. PADAVANO; RONALD L. RAYEVICH; and PATRICIA K. SHERIDAN,	:	
Defendants.	:	

MEMORANDUM OPINION

Date Submitted: May 6, 2010
Date Decided: September 2, 2010

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NOBLE, Vice Chancellor

I. INTRODUCTION

Plaintiffs, current members of a limited liability company, seek leave to amend their complaint which asserts fiduciary duty and contract claims in order to add additional claims and to seek additional remedies, including the appointment of a receiver. Plaintiffs also move for the immediate appointment of a receiver based on the company's insolvency resulting from gross mismanagement and self-dealing by the defendant board. Defendants object to the motion to amend because the amendments will be futile, and object to the appointment of a receiver because neither the limited liability company agreement nor the Delaware Limited Liability Company Act provides for the appointment of a receiver in case of insolvency, and because the Plaintiffs have not alleged behavior sufficiently egregious to merit the appointment of a receiver in accordance with this Court's general equity powers.

II. BACKGROUND

A. *The Parties*

Plaintiffs Gregory N. Senkevitch, Nicholas G. Stathakis, and Gary J. Sopko (collectively, the "Employee Plaintiffs") were members of the senior management of Defendant Advance Realty Group, LLC ("ARG" or the "Company"), a real estate investment and development company. As a form of employment compensation, the Employee Plaintiffs also became equity holders, by way of Class A units, of ARG. Plaintiff Ross Holding and Management Company holds

46,000 Class A units of ARG. Plaintiff ELD Partners, L.P. is the owner of 60,066 Class A units and is affiliated with Senkevitch.

Defendants Peter Cocoziello, D. Pike Aloian, John McGurk, and Ronald L. Rayevich are current members of ARG's Managing Board (the "Board"). Defendants Patricia K. Sheridan and Kurt Padavano were members of ARG's senior management. Defendants Advance Capital Partners, LLC, ("ACP") and Advance Realty Development, LLC ("ARD") are entities owned and/or controlled by Cocoziello that are in the real estate development business. Defendant Five Arrows Realty Securities, III, LLC ("FARS") is an outside investor in ARG and had been a subsidiary of Defendant Rothschild Realty, Inc., but, following a reorganization, is now controlled by Defendant Rothschild Realty Managers, LLC. McGurk and Aloian were and remain principals and managers at FARS and the Rothschild entities.

B. *Brief Background*

In brief, the Plaintiffs bring a series of claims against ARG, its senior management, its principal investors, and the Board on various grounds, including breach of fiduciary duty, breach of contract, estoppel, and tortious interference with contractual opportunity. In part, these claims relate to the management of ARG and its effect on the value of the Plaintiffs' Class A units. In addition, the Employee Plaintiffs tender claims related to their employment agreements with

ARG as well as the circumstances surrounding their termination from the Company. Most importantly for purposes of this memorandum opinion, the Plaintiffs assert that the members of the Board were and remain engaged in self-dealing transactions and have operated the Company for their individual benefit and to the detriment of ARG's Class A unit holders. The Plaintiffs assert that ARG founder Cocoziello and the directors affiliated with FARS are, in effect, looting the Company for the benefit of Cocoziello and FARS.[1]

In their motion to appoint a receiver, the Plaintiffs have put forward substantial documentary evidence which, they assert, establishes that ARG is insolvent as a result of the conduct at issue in this case. As there is some question as to ARG's ability to continue as a going concern, the Plaintiffs now seek a receiver to manage the Company's affairs, in order to prevent the Board from further disposing of the Company's assets for personal gain.

C. *Procedural History*

The Defendants previously moved for judgment on the pleadings with respect to a number of Plaintiffs' claims, seeking to have those claims dismissed on grounds of release and parol evidence. They also asked that Rothschild Realty, Inc. be dismissed because of a lack of personal jurisdiction. Certain claims for breach of the duty of good faith and for tortious interference relating to the

[1] For additional background regarding this dispute, see *Ross Holding and Mgmt. Co. v. Advance Realty Group, LLC*, 2010 WL 1838608, at *1-*4 (Del. Ch. Apr. 28, 2010).

Employee Plaintiffs were dismissed, and the motion to dismiss as to jurisdiction was deferred, pending additional discovery. This memorandum opinion addresses the Plaintiffs' motion for leave to amend the complaint and their motion to appoint a receiver.

III. MOTION TO AMEND THE COMPLAINT

The Plaintiffs move to amend their Verified Complaint pursuant to Court of Chancery Rule 15 in order to seek additional relief in the form of the appointment of a receiver, to allege an additional claim for violation of 6 *Del. C.* § 18-305, and to reframe certain counts involving the dismissal of the Employee Plaintiffs. The Defendants oppose the motion because the proposed amendments seek relief that is unavailable to Plaintiffs, fail to state an actionable claim, or would otherwise be futile.

Court of Chancery Rule 15(a) provides that a "party may amend the party's pleading . . . by leave of [the] Court . . . and leave shall be freely given when justice so requires."[2] Rule 15 allows for liberal amendment in the interest of resolving cases on the merits.[3] A motion for leave to amend a complaint is always addressed to the discretion of the trial court.[4] Nevertheless, "[i]n the absence of undue prejudice, undue delay, bad faith, dilatory motive or futility of amendment,

[2] Ct. Ch. R. 15(a).
[3] *Utz v. Utz*, 1998 WL 670920, at *2 (Del. Ch. Aug. 10, 1998).
[4] *Bokat v. Getty Oil Co.*, 262 A.2d 246, 251 (Del. 1970).

leave to amend should be granted."[5] Thus, in the absence of demonstrable prejudice and unless there has been improper conduct,[6] the proposed amended complaint is subject to the same familiar standard as a motion to dismiss:[7] leave to amend should not be granted "where it appears with a reasonable certainty that the plaintiff would not be entitled to the relief sought under any reasonable set of facts properly supported by the complaint because such amendments would be futile."[8]

A. *Injunctive Relief as a Possible Remedy*

The Plaintiffs desire to add a demand for "[i]njunctive relief in the form of the appointment of a receiver empowered to manage the affairs of the Company, protect and preserve the assets of the Company, and to take such action as is necessary to recover for any losses the Company suffered at the hands of defendants."[9] The Defendants argue that such relief is unavailable to the Plaintiffs because neither Delaware's Limited Liability Company Act (the "LLC Act")[10] nor ARG's Operating Agreement allows for the appointment of a receiver under the circumstances alleged in the proposed Amended Verified Complaint. Thus,

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[5] *Cantor Fitzgerald, L.P. v. Cantor*, 1999 WL 413394, at *2 (Del. Ch. June 15, 1999) (citing *Fox v. Christina Square Assoc., L.P.*, 1995 WL 405744, at *2 (Del. Ch. June 19, 1995)).
[6] *See, e.g.*, *Utz*, 1998 WL 670920, at *2; *Seaford Funding L.P. v. M & M Assoc. II, L.P.*, 1996 WL 255886, at *1 (Del. Ch. Apr. 9, 1996).
[7] *See, e.g.*, *Moore Bus. Forms, Inc. v. Cordant Holdings Corp.*, 1995 WL 707877, at *3 (Del. Ch. Nov. 30, 1995).
[8] *FS Parallel Fund L.P. v. Ergen*, 2004 WL 3048751, at *2 (Del. Ch. Nov. 3, 2004).
[9] Pls.' Mot. for Leave to File First Am. Verified Compl., Ex. A ("Am. Compl.") at 82.
[10] 6 *Del. C.* ch. 18.

according to Defendants, an amendment seeking to add such a remedy would be futile.

The Court has inherent power as a court of equity to grant such remedies as would be just, whether or not such remedies are expressly provided for by statute or contract. There is no reason to conclude that the appointment of a receiver pursuant to the Court's general equity powers would be unavailable under the facts alleged in the proposed Amended Verified Complaint.[11] As such, the Court will not preclude the appointment of a receiver as an available remedy to the Plaintiffs, and they are free to amend the Verified Complaint accordingly.[12]

B. *Claim Under 6* Del. C. *§ 18-305*

The Plaintiffs also seek to add a claim against certain Defendants for violation of 6 *Del. C.* § 18-305(g), which requires unanimous member approval of any amendments to limited liability company operating agreements that function to limit a member's ability to obtain certain information. The Defendants counter that the Second Amended and Restated Operating Agreement (the "2008 Operating

[11] The specific factual allegations relating to the appointment of a receiver are set forth in Part IV B *infra*. In short, the proposed amendments, if true and if favorable inferences were drawn for the Plaintiffs, would place appointment of a receiver within the Court's discretion. As will be seen, however, there are material facts in dispute that, at this stage, preclude the Court from reaching the point where it might exercise its discretion.

[12] The Defendants argue that the proposed Amended Verified Complaint's language amounts to a request for a permanent receiver as final relief, which is unavailable as a final remedy. However, the language need not be read so narrowly as to preclude the appointment of a receiver *pendente lite* as an interim remedy.

Agreement") does not limit its members' rights to obtain the information provided for in the statute and therefore could not violate 6 *Del. C.* § 18-305(g).

The argument that the Plaintiffs put forward is that, in conjunction with the September 2008 signing of a Conversion and Exchange Agreement between and among ARG, FARS, ACP, and ARD (the "Conversion Agreement")—which revised the capital structure of ARG, allowed FARS to convert Company debt into a majority stake in ARG, caused the Company to begin liquidating its real estate portfolio, and transferred ARG properties to ACP and ARD—the Defendants once more amended the Amended and Restated Operating Agreement of Advance Realty Group, LLC Dated as of August 6, 2001 (the "2001 Operating Agreement") in its entirety, which had the effect of removing and otherwise restricting the Plaintiffs' right to access the Company information that they now seek. 6 *Del. C.* § 18-305(g) specifically prohibits amendments or agreements that restrict a member's rights to obtain the information delineated in § 18-305(a), unless such amendments or agreements are approved by all members of the limited liability company, which did not occur here.

Specifically, the Plaintiffs point to § 12.02 of the 2001 Operating Agreement, which previously established a Board obligation to provide members, by the end of the fiscal year, "(i) financial statements . . . , including a balance sheet and statements of income and changes in financial position showing the cash

distributed in such year, (ii) a report of the activities of the Company during such year and (iii) a Schedule K-1 and such other tax information as may reasonably be needed. . . ."[13] Subsequently, as part of the Conversion Agreement, the Defendants deleted § 12.02 from the 2008 Operating Agreement and, moreover, changed the law governing the Operating Agreement from Delaware law to New York law, which, the Plaintiffs contend, modifies the Plaintiffs' right to access ARG's financial information.[14]

However, as Defendants point out, the 2008 Operating Agreement does not purport to restrict in any way the rights of its members to obtain information pursuant to 6 *Del. C.* § 18-305(a) and, indeed, is silent on this issue. If the Plaintiffs retain every right that was available under 6 *Del. C.* § 18-305(a) there can be no violation of 6 *Del. C.* § 18-305(g), whether or not the amended agreement limits any broader contractual rights to company information that may have been available under the prior agreement.

With respect to the change from Delaware law to New York law, the Plaintiffs have been unable to articulate how their statutory information access rights have been modified, if at all, by the choice of law change. Should New York's information access provisions prove more expansive than Delaware's, it

[13] Affidavit of D. Pike Aloian in Supp. of Defs.' Br. in Opp'n to Pls.' Mot. for Leave to File First Am. Verified Compl. ("Aloian Aff.") Ex. A ("2001 Operating Agreement") § 12.02.
[14] *See* Aloian Aff. Ex. B ("2008 Operating Agreement") § 13.5.

cannot be said that importing New York law to the 2008 Operating Agreement functioned to limit Plaintiffs' ability to obtain the Company information delineated under 6 *Del. C.* § 18-305(a). Until Plaintiffs can establish that the choice of law modification adversely affects their information access rights, their motion to amend the Complaint to add a count under 6 *Del. C.* § 13-305(g) is denied.

C. *The Claims of the Employee Plaintiffs*

The Defendants' final point of opposition to the Plaintiffs' motion to amend—that those claims involving the Employee Plaintiffs have been released and, thus, that it would be futile to add further to them—is also without merit, in light of this Court's April 28, 2010, memorandum opinion and order allowing those claims to survive the Defendants' motion to dismiss. As Defendants themselves acknowledged in their brief in opposition to this motion, filed before the Court's April memorandum opinion, the claims involving the Employee Plaintiffs in the proposed Amended Verified Complaint reassert the associated claims in the original Complaint "almost word-for-word."[15] Because the Amended Verified Complaint merely restates these counts in slightly different language, the claims involving the Employee Plaintiffs that survived the Defendants' motion for judgment on the pleadings—Counts 7 through 10 and 15 of the proposed Amended

[15] Defs.' Br. in Opp'n to Pls.' Mot. for a Leave to File First Am. Verified Compl. at 12.

Verified Complaint—are not futile. As such, the Plaintiffs may file an amended pleading which continues to assert them.

IV. MOTION TO APPOINT A RECEIVER

The Plaintiffs have also moved for the appointment of a receiver, alleging that the Defendants have rendered the Company insolvent through gross mismanagement and self-dealing. Specifically, the Plaintiffs assert that the members of ARG's Board:

> [have] increased ARG's liabilities and have diverted the company's cash and other assets to themselves, rendering the company insolvent . . . are defaulting (in some case, purposely) on the company's secured debt, and in fact have lost certain properties to lenders . . . have defaulted on the company's preferred debt, risking acceleration of $60 million in loans . . . have defaulted on the company's senior subordinated debt, totaling more than $70 million . . . have actually purchased some of the company's debt to benefit personally from the purposeful defaults . . . have outsourced their management responsibilities; and ARG's independent auditors have expressed skepticism with ARG management, . . . have criticized its internal financial team as incompetent, and . . . questioned the company's ability to continue as a going concern in 2010.[16]

The Defendants counter that the Company's travails have been driven by the abysmally poor state of the real estate market as a whole and that ARG's Board has tried to make the most out of an extremely difficult situation. They argue that, because neither ARG's Operating Agreement nor the LLC Act authorizes the appointment of a receiver in circumstances akin to ARG's, only a receiver

[16] Br. in Supp. of Pls.' Mot. for Appointment of a Receiver for Def. Advance Realty Group, LLC at 1 (summarizing Am. Compl. ¶¶ 77-177).

pendente lite under the Court's inherent equitable powers could be appointed, but that Plaintiffs have not shown any "fraud, gross mismanagement, or extreme circumstances causing imminent danger of great loss" sufficient to merit this extreme remedy.[17]

A. *Standard for Appointing a Receiver*

Both parties acknowledge that the LLC Act, except when the certificate of formation has been canceled, is silent on the issue of when the appointment of a receiver is appropriate. The Plaintiffs assert that 6 *Del. C.* § 18-1104, which instructs that "[i]n any case not provided for in this chapter, the rules of law and equity . . . shall govern," establishes support for engrafting upon the LLC Act the statutory standard established by 8 *Del. C.* § 291 for appointing a receiver where a corporation is insolvent.[18] Traditionally, when considering whether to appoint a receiver in the corporate context under 8 *Del. C.* § 291, courts have employed the "insolvency plus" standard, under which the moving party must prove that the

[17] Defs.' Br. in Opp'n to Pls.' Mot. for Appointment of a Receiver at 22, 24.

[18] 8 *Del. C.* § 291 reads as follows:

> Whenever a corporation shall be insolvent, the Court of Chancery, on the application of any creditor or stockholder thereof, may, at any time, appoint 1 or more persons to be receivers of and for the corporation, to take charge of its assets, estate, effects, business and affairs, and to collect the outstanding debts, claims, and property due and belonging to the corporation, with power to prosecute and defend, in the name of the corporation or otherwise, all claims or suits, to appoint an agent or agents under them, and to do all other acts which might be done by the corporation and which may be necessary or proper. The powers of the receivers shall be such and shall continue so long as the Court shall deem necessary.

company is insolvent, plus additional facts that demonstrate that the intervention of a neutral third party is necessary to protect the rights and interests of either the company or the moving parties.[19]

The Defendants contend that the appointment of a receiver has traditionally been an equitable power reserved to the Court's discretion, and that fundamental differences between limited liability companies and corporations make it inappropriate to assume that the General Assembly intended to subject LLCs to the grounds for appointing a receiver made available under 8 *Del. C.* § 291. They assert that the LLC Act's silence as to the appointment of a receiver in the context of insolvency signals the General Assembly's intent not to subject LLCs to these less burdensome grounds for appointing a receiver.

The members of a limited liability company are afforded substantial flexibility in establishing their own rules of governance.[20] "The basic approach of the LLC Act is to provide members with broad discretion in drafting the Agreement and to furnish default provisions when the members' agreement is

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[19] *See, e.g.*, *Production Resources Group, L.L.C. v. NCT Group, Inc.*, 863 A.2d 772, 785 (Del. Ch. 2004).

[20] See 6 *Del. C.* § 18-1101(b) ("It is the policy of this chapter to give the maximum effect to the principle of freedom of contract and to the enforceability of limited liability company agreements."). *See also In re Seneca Inv. LLC*, 970 A.2d 259, 261 (Del. Ch. 2008) ("An LLC is primarily a creature of contract, and the parties have wide contractual freedom to structure the company as they see fit."); *Walker v. Resource Dev. Co. Ltd., L.L.C.*, 791 A.2d 799, 813 (Del. Ch. 2000) ("Once members exercise their contractual freedom in their limited liability company agreement, they can be virtually certain that the agreement will be enforced in accordance with its terms.") (citation omitted).

silent."[21] Here, both the 2001 Operating Agreement and the 2008 Operating Agreement place the exclusive authority to manage ARG, to liquidate the Company, and to wind up its affairs in the Board.[22]

Likewise, the LLC Act includes only a single provision addressing when a receiver may be appointed: 6 *Del. C.* § 18-805, which allows for the appointment of a receiver only when a limited liability company's certificate of formation has been cancelled. The LLC Act was written long after our corporate statutes and several of those provisions have been incorporated into the LLC Act. Notably, 6 *Del. C.* § 18-805 tracks closely 8 *Del. C.* § 279, the general provision establishing the process for appointing a receiver in the corporate context, with the notable difference being the circumstances in which a receiver may be appointed.[23] This seems to suggest that the omission in the LLC Act of the provision for appointing a receiver in the case of insolvency was an intentional, not an inadvertent, act by the General Assembly.[24]

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[21] *Schuss v. Penfield Partners, L.P.*, 2008 WL 2433842, at *6 n.15 (Del. Ch. June 13, 2008).
[22] *See* 2001 Operating Agreement §§ 7.01, 10.02; 2008 Operating Agreement §§ 3.1(a), 12.3.
[23] *Compare* 8 *Del. C.* § 279 (describing a process for appointing a receiver "[w]hen any corporation organized under this chapter shall be dissolved in any manner whatever") *with* 6 *Del. C.* § 18-805 (describing the process for appointing a receiver "[w]hen the certificate of formation of any limited liability company formed under this chapter shall be canceled").
[24] *Leatherbury v. Greenspun*, 939 A.2d 1284, 1291 (Del. 2007) ("[W]hen provisions are expressly included in one statute but omitted from another, we must conclude that the General Assembly intended to make those omissions."). *See also In re Seneca*, 970 A.2d at 261 n.1 (applying corporate law provisions to the limited liability company at issue "because the parties contractually agreed that the LLC would be governed as a corporation and Delaware General Corporation Law would apply").

The Plaintiffs point to case law where courts have borrowed from the corporate law when the LLC Act was silent as to a particular provision. However, the example that they use, where the court looked to the corporate law to determine the default fiduciary duties that limited liability company members owe to one another[25] was based not on statute but on the common law treatment of fiduciary duties. Moreover, the LLC Act refers to fiduciary duties,[26] but is silent as to their contours. Our courts had developed standards for the appointment of a receiver long before the codification of 8 *Del. C.* § 279 and there was no obvious statutory gap in need of filling with respect to the appointment of a receiver on grounds of insolvency.[27] Indeed, some courts have suggested that insolvency may be a necessary condition for appointing a receiver under the court's general equitable powers.[28] That § 279 establishes a lesser basis for appointing a receiver does not mean that the rules of equity do not already account for insolvency in determining the appropriateness of appointing a receiver. There is no need to borrow from the corporate statute where a more general standard is well-established in our law,

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[25] *Bay Ctr. Apartments Owner, LLC v. Emery Bay PKI, LLC*, 2009 WL 1124451, at *8 n.33 (Del. Ch. Apr. 20, 2009).
[26] *See* 6 *Del. C.* § 18-1101(c).
[27] *See, e.g.*, *Lichens Co. v. Standard Commercial Tobacco Co.*, 40 A.2d 447, 451 (Del. Ch. 1944) (describing the appointment of a receiver *pendente lite* as "one of the oldest remedies in equity").
[28] *See, e.g.*, *Thoroughgood v. Georgetown Water Co.*, 77 A. 720, 723 (Del. Ch. 1910) (holding that the court should only appoint a receiver on the basis of "gross mismanagement, positive misconduct, or other grounds showing a breach of trust on the part of the officers of the corporation, and probably, except in rare cases, only when insolvency has resulted from such misconduct."); *Lichens*, 40 A.2d at 451-52 (same).

particularly with respect to questions of equity. As such, the Court accepts that a receiver may only be appointed in this case in accordance with its general equity powers.

B. *Should a Receiver be Appointed at this Stage?*

Because a receiver is unavailable under either the LLC Act or any version of the Operating Agreement, the only basis for appointing a receiver is by way of the Court's general equity powers.[29] As a general matter, "the appointment of a receiver is an extraordinary, a drastic and . . . an 'heroic' remedy. It is not to be resorted to if milder measures will give the plaintiff, whether creditor or shareholder, adequate protection for his rights."[30] As such, courts of equity exercise this power "with great caution and only as exigencies of the case appear by proper proof. . . ."[31] This is particularly the case where the entity continues to function actively. As this Court put it many years ago:

> [A] receiver *pendente lite* for a corporation actively functioning is never to be justified except under circumstances that show an urgent need for immediate protection against injury either in the course of actual infliction or reasonably to be apprehended. As the remedy is a

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[29] *See, e.g.*, *Carson v. Allegany Window Glass Co.*, 189 F. 791, 795 (C.C. Del. 1911) (holding that, where there is a lack of statutory authority for appointing a receiver, any right to do so must, instead, "be found in the general equity powers of this court sitting as a court of chancery"). *See also Whitmer v. William Whitmer & Sons*, 99 A. 428, 430 (Del. Ch. 1916) ("While there is no statutory power to appoint a receiver *pendente lite*, the inherent, or implied, and certainly well-established powers of the Court of Chancery administered by the Chancellor are such as to vest in him the jurisdiction to take possession of the assets and affairs of a corporation, by a receiver *pendente lite*, in order to prevent loss to those interested.").

[30] *Maxwell v. Enterprise Wall Paper Mfg. Co.*, 131 F.2d 400, 403 (3d Cir. 1942).

[31] *Thoroughgood*, 77 A. at 723.

> stringent one and fraught often times when asked for with the possibilities of as much if not more harm than that which it seeks to avoid, it should be applied with scrupulous care. Only emergent situations can evoke its application.[32]

Consequently, a court may utilize its equitable powers to appoint a receiver only "when fraud and gross mismanagement by corporate officers, causing real imminent danger of great loss, clearly appears, and cannot be otherwise prevented."[33] Moreover, "a receiver will never be appointed except under special circumstances of great exigency and when some real beneficial purpose will be served thereby."[34] Nor will a court of equity appoint a receiver simply because of errors of judgment in business management.[35]

The Defendants argue that a receiver *pendente lite* should not be appointed because none of the Plaintiffs' allegations reaches the undoubtedly high threshold necessary to invoke this equitable remedy: that there is no evidence of fraud, gross mismanagement, or other extreme circumstance causing the imminent danger of great loss.

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[32] *Salnita Corp. v. Walter Holding Corp.*, 168 A. 74, 76 (Del. Ch. 1933). *See also Moore v. Associated Producing & Refining Corp.*, 121 A. 655, 656 (Del. Ch. 1923) ("While it is settled that a court of equity has the power to appoint a receiver pendente lite, it is equally well settled that such power should not be exercised except in a clear case, when it is necessary for the prevention of manifest wrong and injury, and where the plaintiff would otherwise be in danger of suffering irreparable loss.").

[33] *Drob v. Nat'l Mem'l Park*, 41 A.2d 589, 597 (Del. Ch. 1945). *See also Maxwell*, 131 F.2d at 403; *Securities & Exchange Comm. v. Fiscal Fund, Inc.*, 48 F. Supp. 712, 715 (D. Del. 1943); *Lichens*, 40 A.2d at 452; *Thoroughgood*, 77 A. at 723.

[34] *Drob*, 41 A.2d at 597. *See also Lichens*, 40 A.2d at 451-52; *Salnita*, 168 A. at 76.

[35] *Lichens*, 40 A.2d at 452.

Nevertheless, where the Plaintiffs have alleged facts that, if true, would constitute sufficient grounds for appointing a receiver *pendente lite* but where questions of fact remain in dispute, the appropriate resolution of the Plaintiffs' motion would not be dismissal but a trial on the accuracy of the facts put forward. As such, the Court will consider whether the lengthy allegations outlined in Plaintiffs' papers assert facts that would, either in trial or on the record the parties have provided, allow it to conclude that appointing a receiver *pendente lite* would be an appropriate remedy at this stage.

The Plaintiffs allege numerous infractions by the Board, most of which involve allegations of self-dealing. The wrongful acts alleged by the Plaintiffs fall into three principal categories: (i) that the Board has transferred properties to companies affiliated with Cocoziello for no consideration but while continuing to guarantee the underlying loans; (ii) that the Board has allowed the Company to default on loans, putting ARG at risk of being declared in default, all the while making unnecessary interest payments on loans owed to insiders; and (iii) that, in a time of financial crisis, the Company has inappropriately compensated its senior management and provided millions of dollars to Board members. The Court will focus on the more serious charges made by the Plaintiffs in determining whether there may be grounds for appointing a receiver.

1. Property Transfers to the Cocoziello Entities

After the Conversion Agreement, ARG transferred some or all of its interest in at least eleven properties to ARD, an entity owned and controlled by Cocoziello, for apparently little or no consideration. The Plaintiffs point out that McGurk testified that these transfers provided "very little" benefit to the Company[36] which, they suggest, is evidence that these transfers were inappropriate. However, McGurk also explained that reducing the Company's interest in these properties reduced its obligations to fund those properties' contingent liabilities while the retained ownership stake still allowed the Company to have upside potential in those properties should they ultimately prove successful. McGurk elaborated upon this rationale in the context of the Harrison Property, where the Company reduced its equity stake from 25% to 10% for no consideration:

> [b]ecause it was very difficult to quantify the upside of Harrison. It could be enormous but it also had like many of the assets that got transferred to ARD had capital needs. So, we essentially reduced by . . . transferring Harrison over there, reduce the potential contingent liability of having to fund it. So, that's a benefit plus it received the 10 percent interest which gave them 10 percent interest in the upside.[37]

Yet, despite reducing or eliminating its equity interest in these properties, ARG has agreed to continue guaranteeing some or all of the underlying loans on at least four

[36] Affidavit of Gregory Senkevitch in Supp. of Pls.' Mot. for Appointment of a Receiver for Def. Advance Realty Group, LLC ("Senkevitch Aff.") Ex. 1 ("McGurk Dep. Tr.") at 97.
[37] *Id.* at 101.

of these properties, a combined obligation well in excess of $75 million. In fact, with respect to the Harrison Property, ARG has recently expanded the size of its debt repayment obligations.[38] The Defendants do not offer up a separate business justification for these continued obligations.[39]

2. Selectively Making Interest Payments Only on Insider-Held Debt

ARG has failed to meet its payment obligations on various loans and mortgages on its properties, which, the Plaintiffs allege, puts the Company at risk of lenders declaring defaults on these loans, thereby entitling them to immediate repayment in full.[40] Some of the loans in arrears were allegedly purchased at a discount by entities affiliated with the Defendants.[41] The Defendants assert that its failure to make payments on this debt is due to the challenging real estate environment and the need to preserve its limited cash supply; and that its failure to

[38] Specifically, ARG obtained a $9.9 million increase in its first mortgage loan facility with Wells Fargo, and this increase corresponded with an increase in ARG's joint and several guarantee of the $29.3 million loan and a continuation (and possible increase) of ARG's covenant to maintain liquid assets in the amount of $10 million to support that guarantee.

[39] Moreover, for at least one property that carries a loan guaranteed by ARG, ARD has already failed to make its property tax and insurance payments.

[40] With respect to those mortgages upon which ARG ceased to make payments, including two properties in Manalapan, New Jersey, which the creditor took back, the Defendants explain that the default was intentional because the underlying loan exceeded the value of the property and the rental income would not cover the loan payments. However, the Plaintiffs argue that, instead of giving up the properties altogether, the Board should have instead looked for a tenant who could have provided sufficient income to service the debt, which the Plaintiffs claim ARG did not adequately attempt to do.

[41] Cocoziello purchased the Picatinny promissory note from Wells Fargo through another of his entities, Forge Funding. Thereafter, ARD defaulted on the loan, which is guaranteed by ARG. The Plaintiffs admit that "[t]he purpose behind this self-dealing transaction is unclear." Br. in Supp. of Pls.' Mot. for Appointment of a Receiver for Def. Advance Realty Group, LLC at 10.

keep these accounts current is not gross mismanagement but a legitimate business decision entitled to deference by the Court.

Additionally, the Company has purposefully defaulted on its most senior unsecured debt, $60 million in Trust Preferred Securities ("TPS") issued to Taberna. The TPS require quarterly interest-only payments for thirty years, in which time the principal balance will be due, and contain certain financial statement covenants relating to minimum net worth, maximum interest coverage ratio, and maximum leverage ratio of assets to senior debt. The Defendants argue that ARG chose to be in arrears as to its interest obligations with a legitimate business purpose in mind—because ARG wants to negotiate with Taberna a reduction in the total debt liability, and purposefully defaulting improves their negotiating position[42]—but the Plaintiffs complain that the Defendants do not explain how or why this will help their cause. In addition, the Plaintiffs note that, even if ARG were to cure the interest default, it still could not cure the default with respect to the loan covenants. Indeed, should Taberna declare a default of the TPS, this would trigger the entire $60 million debt to become immediately due and payable. Furthermore, since it is an unsecured debt, the only way for Taberna to protect itself, argue Plaintiffs, would be to pursue a lawsuit to collect the $60

[42] *See* Senkevitch Aff. Ex. 20 ("Sax Macy Internal Memo") at 3 ("We have an understanding from management that they are purposely trying to blow the Taberna covenants to obtain better rates, so we can have management begin to prepare loan waiver letters, which we believe we will need.").

million, even though Taberna has not yet taken any such steps. The Plaintiffs point to a letter from McGurk to the manager of one of FARS's principal investors, the Ohio Public Employees Retirement System ("OPERS"), about the TPS that, they suggest, evidences the Defendants' actual intent to orchestrate a default so that FARS and OPERS can buy the Taberna debt at a discount.[43]

The Plaintiffs argue that the Company's failure to make its debt payments, thereby risking its solvency, amounts to gross mismanagement because the failure to make debt payments that are contractually owed has occurred simultaneously with the Company's use of its cash to make some $5 million in interest payments on debt owed by insiders, despite the fact that the promissory notes pursuant to which the Company made such payments do not provide for or require such payments. If Defendants' business decisions are being driven by a cash flow crisis and the effects of the current economic conditions, argue the Plaintiffs, making unnecessary payments to entities connected to the Board while not making necessary payments to unaffiliated debt holders amounts to self-dealing and gross mismanagement. Nevertheless, ARG is now in arrears on the interest payments on

[43] Senkevitch Aff. Ex. 23 ("[T]here is a remote possibility that we may be able to buy at a discount, the only corporate debt (Trust Preferred) that is senior to FARS III note. If that occurs, there might be an opportunity for OPERS to fund that transaction. The face amount of the Trust Preferred is $60 million.").

notes held by FARS[44] and ACP,[45] which McGurk suggested may constitute a default on these loans, and which could result in action taken by FARS.[46]

3. Compensation Paid to Executives

The Plaintiffs also raise issue with the roughly $33.8 million in payments made to Board members and their related entities.[47] They also complain about "phantom loans" to certain managers[48] and large raises to many members of the

[44] FARS holds two promissory notes: one in the amount of $60 million bearing interest at 9% per annum, and the other in the amount of $20,115,375, bearing interest at 7.5% per annum. The Plaintiffs assert that neither loan requires the payment of interest on a periodic basis. Until recent quarters, the Company paid quarterly interest payments on the unpaid principal balance.

[45] ACP holds a promissory note in the principal amount of $10 million.

[46] McGurk Dep. Tr. at 230-32. The Plaintiffs suggest that McGurk's public admission that the Company's actions vis-à-vis the FARS promissory note constitute a default and that he may take action on behalf of FARS to notify ARG of a breach of the note proves that "he is advancing, and intends to advance, the best interests of FARS" and is "simply not operating with any degree [of] loyalty to ARG." Pls.' Reply Br. in Further Supp. of their Mot. for Appointment of a Receiver for Def. Advance Realty Group at 14.

[47] The $33.8 million paid to members of the Board or their related entities from the time of the Conversion Agreement through August 14, 2009, is broken down as follows: (1) $10,215,561 to ARD sometime in late 2008; (2) $1,183,562 to FARS on its Pre-Conversion Senior Notes at the conversion date; (3) $177,534 to FARS on its post-conversion senior notes on September 30, 2008; (4) $236,129 to ACP on its preferred units at the conversion date; (5) $35,531 to ACP on its post-conversion senior and junior notes on September 30, 2008; (6) $5,212,779 retained by ARD from the prior year's ARG transactions as part of the Conversion Agreement transactions; (7) $3,292,151 in proceeds of a sale of the ARC Rockville property retained by ARD near the time of the Conversion Agreement; (8) $2,133,904 in proceeds from the sale of 7 Entin Road retained by ARD, despite the fact that the property was not owned by ARD; (9) $4,917,057 paid to FARS and ACP in interest payments on the subordinated notes; (10) $4,000,000 to Cocoziello personally for tax indemnification on a property sale; (11) $1,531,148 in charges from Advance Realty Management, LLC, another Cocoziello entity, including year-end bonus payments to management; and (12) $918,509 in management fees to ARM through June 30, 2009. Br. in Supp. of Pls.' Mot. for Appointment of a Receiver for Def. Advance Realty Group, LLC at 16-18.

[48] The Company granted a loan of $230,000 to Sheridan and a loan of $325,000 to Kevin Tartaglione, another member of ARG management. Senkevitch Aff. Exs. 29 & 30. These amounts were treated as advances on future wages, to be amortized and recorded as wage income over three to five years.

senior management at ARG. They assert that making large payments to Board members and giving raises to senior management when the company is cash strapped and simultaneously defaulting on most of its secured and senior debt obligations "is not simple mismanagement, it is gross mismanagement and self-dealing."[49]

The Defendants assert that the payments to members of the Board and their related entities were made pursuant to contractual obligations, and that most were done in connection with the 2008 Conversion Agreement which, Defendants contend, saved the Company from an immediate liquidation and allowed it to continue as a going concern. Further, ARG's outside auditor, Sax Macy, reviewed the payments and found no improprieties. They claim that the Board members have deferred millions of dollars in payments owed to them from ARG in order to preserve the Company's cash and help it weather the current storm. The Plaintiffs respond that contractual obligations do not necessarily abrogate the Board's duty to manage the Company in good faith and in its best interests, free from conflicts or self-dealing, and that many of the payments the Defendants made to themselves, such as the debt interest payments, were *not* contractually required.

With respect to allegedly excessive management compensation, the Plaintiffs respond to the Defendants' assertion that they have substantially reduced

[49] Pls.' Reply Br. in Further Supp. of their Mot. for Appointment of a Receiver for Def. Advance Realty Group at 18.

the Company's overall costs because a number of employees have been let go and those that remain have increased job responsibilities by suggesting that most of the properties have either been given away to Cocoziello or have been outsourced to outside management; thus, there is little left to manage.

According to Plaintiffs, these transactions, in conjunction with questions of insolvency surrounding ARG—including some skepticism expressed by Sax Macy over the Company's ability to continue as a going concern—"confirm that ARG is being run by a group of managers who are so terribly conflicted in their obligations that they cannot, even when a lawsuit has been filed against them, act in the best interests of ARG and its unit holders"[50] and "require the appointment of a receiver to manage in good faith the affairs of ARG."[51]

* * *

Despite the requirement that clear evidence of fraud, gross mismanagement, or other extraordinary circumstance causing imminent danger of real loss must be presented for the Plaintiffs to succeed on their motion to appoint a receiver, the Court cannot conclude that the Plaintiffs have not asserted facts that, if true and accurate, would meet this high standard. Nevertheless, because material facts remain in dispute, in particular, with respect to the motives and objectives of the Board in, for example, transferring properties to Cocoziello and in paying interest

[50] *Id.* at 20.
[51] *Id.* at 19.

only to debt held by insiders, it will be necessary to hold a trial in order to further develop the necessary factual record for a fair assessment of their application. Thus, Plaintiffs' motion for appointment of a receiver is denied.

C. *Do Plaintiffs Have an Adequate Remedy at Law that Would Preclude the Appointment of a Receiver?*

The Defendants suggest that the Plaintiffs have an adequate remedy at law by way of the damages they seek, and that the existence of this remedy operates to preclude any equitable remedies, including the appointment of a receiver.[52] The Defendants reason that, should the Plaintiffs successfully prove any breach of duty on the part of ARG's management, they will be fully compensated by damages. Moreover, because the breach of fiduciary duty claims do not run against the Company, whether or not ARG is solvent will not affect the collectibility of a judgment.

It is unclear how routinely courts employ this possibility to preclude the appointment of a receiver.[53] Moreover, the Plaintiffs' outstanding claims include claims for breach of contract, promissory estoppel, and fraudulent inducement against ARG which could be affected by the Company's insolvency between now

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[52] *See, e.g.*, *MetCap Sec. LLC v. Pearl Senior Care, Inc.*, 2009 WL 513756, at *6 (Del. Ch. Feb. 27, 2009) (quoting *Morales v. Trans World Airlines, Inc.*, 504 U.S. 374, 381 (1992) ("It is a basic doctrine of equity jurisprudence that courts of equity should not act when the moving party has an adequate remedy at law . . . .")), *aff'd*, 977 A.2d 899 (Del. 2009).

[53] *See Maxwell*, 131 F.2d at 402 n.4 ("As to the limitation on the exercise of the power [to appoint a receiver] in cases where there is any other adequate remedy . . . the rule, while stated in general terms and never directly denied, is often disregarded, and this tendency is growing in some jurisdictions. . . .").

and when a final judgment may be entered.[54] As such, the fact that the Plaintiffs seek money damages from other Defendants would not operate to preclude the appointment of a receiver *pendente lite*.

V. CONCLUSION

For the foregoing reasons, the Plaintiffs' motion to amend the complaint is granted except as to Count 5, alleging a violation of 6 *Del. C.* § 18-305, and as to Counts 11 through 14[55] of the proposed Amended Verified Complaint. The Plaintiffs' motion to appoint a receiver is denied pending trial on the underlying disputed facts. An implementing order will be entered.

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[54] *See also Feldman v. Pennroad Corp.*, 60 F. Supp. 716, 719 (D. Del. 1945) (noting that "proof of fraudulent and reckless mismanagement of the corporate business by its board of directors such as would convince the Court that further control of the corporation by the same board would result in the destruction of its business or cause unwarranted loss to the stockholders will call into exercise the discretionary power of the Court to appoint a receiver" so long as the misconduct is current rather than prospective and the danger to the corporation is imminent).

[55] These counts, although bearing slightly different numbers, were dismissed earlier and no reason exists for allowing them to be replead. *Ross Holding and Mgmt. Co.*, 2010 WL 1838608, at *9-*10.