

Jolly Roger Fund, LP, et al. v. Prime Group Realty Trust, et al. (motion to dismiss, claim alleging breach of contract and implied duty of good faith and fair dealing, breach of fiduciary duty and unjust enrichment)

In *Jolly Roger Fund, LP, et al. v. Prime Group Realty Trust, et al.*¹, Plaintiffs Jolly Roger Fund, LP et al. filed an amended complaint against Defendants Prime Group Realty Trust (PGRT) and Lightstone Group (“Lightstone”) alleging breach of contract, breach of implied duty of good faith and fair dealing, breach of fiduciary duty and unjust enrichment. The plaintiffs consisted of shareholders collectively owning Series B Redeemable Preferred Shares of Beneficial Interest of Prime Group Realty Trust.

When PGRT first went public, it owned more than seventy office and industrial properties. By 2004, however, and within seven months after Lightstone acquired all of PGRT’s common stock, PGRT had sold all but 12 properties. During the same period, Lightstone received dividends from PGRT totaling \$76 million dollars. In contrast, and only months after a distribution to Lightstone, the PGRT board cited liquidity problems when deciding not to pay a scheduled dividend on the Series B Preferred Shares. At the heart of plaintiffs’ complaint was the assertion that PGRT had been liquidated as a result of its actions and that, as a result, plaintiffs were entitled to the \$25 per share “liquidation preference” they were due as preferred shareholders in the event of a dissolution, liquidation or winding up of PGRT as provided in PGRT’s Articles of Amendment and Articles Supplementary.

In considering the plaintiffs’ motion, the Court undertook a review of PGRT’s Articles of Amendment and Articles Supplementary. Plaintiffs and defendants each agreed that those documents governed PGRT’s classes of outstanding stock, the Articles Supplementary setting forth the terms and conditions applicable exclusively to the Series B Preferred Shares. The Articles Supplementary, while providing for the \$25 per share liquidation preference, also limited what events could constitute a liquidation. Among those events not considered a liquidation were a consolidation or merger with one or more corporations, real estate investment trusts or other entities, a sale, lease or conveyance of all or substantially all of PGRT’s property or business, or a statutory share exchange.

In its breach of contract claim, plaintiffs asserted that Lightstone had caused PGRT to liquidate its property to enrich Lightstone at the expense of minority preferred shareholders. However, plaintiffs were forced to concede to the Court that PGRT was not formally in liquidation and to argue that the sale of the properties amounted to a constructive liquidation. The plaintiffs were also forced to acknowledge that the Articles Supplementary specifically stated that the sale or lease of all of PGRT’s property was not considered to be a liquidation, although the plaintiffs argued that the Articles were silent as to what more was necessary in addition to a sale to constitute a liquidation of PGRT. The defendants, in turn, argued that the Articles Supplementary indicated that only a formal liquidation would entitle the plaintiffs to any preference payment, subject to the express terms of the contracts governing the agreement between the parties to the dispute.

¹ Maryland Business and Technology Case Management Program, Case No. 24-C- 06-010433 (8/16/07, Berger, J.), available at <http://www.baltocts.sailorsite.net/about/publications/opinions/JollyRoger.pdf>.

At the crux of plaintiffs' breach of contract argument was the assertion that the use of the word "any" in the Articles Supplementary provision regarding liquidation was ambiguous and should be construed against PGRT, the drafter, to mean either a formal, informal or de facto liquidation could be deemed a liquidation that would trigger the liquidation preference. In addressing the de facto liquidation argument, the Court considered several relevant Delaware Court of Chancery decisions that set forth factors for determining whether a de facto liquidation had taken place. Under *Quadrangle Offshore (Cayman) LLC v. Kenetech Corp.*², *Quadrangle Offshore (Cayman) LLC v. Kenetech Corp.*³ and *Rosan v. Chicago Milwaukee Corp.*⁴, a finding of de facto liquidation requires a plaintiff to demonstrate more than just the sale or liquidation of some, or all, of a business's assets. It requires a showing that a business is "winding up" its affairs and undertaken an "abandonment" of its corporate identity as opposed to undertaking some other lawful course of action permitted under its organizing contract.

The Court decided that the language in the Articles of Amendment and Articles Supplementary was clear and unambiguous in that it specifically stated that the sale of all or substantially all of PGRT's property was not to be considered a liquidation. The Court noted that the plaintiffs had agreed to the terms of the Articles Supplementary when they purchased their shares and declined to add terms or clauses to the agreement. The Court stated further that, even if plaintiffs were entitled to a liquidation preference under a de facto liquidation, they had not satisfied any of the factors set forth in the Delaware cases. Defendants successfully argued that while they had sold some properties, they had retained ten rental properties and had not fired all of their employees, set up severance for their officers, discontinued board meetings or otherwise abandoned the form of PGRT as had occurred in *Quadrangle*. In *Quadrangle*, the Court of Chancery still held that no liquidation had occurred because the defendant entity in that case was judged to have remained a going concern.

In its breach of duty of good faith and fair dealing claim, plaintiffs argued that all contracts under Maryland law contained such implied duties. Plaintiffs further contended that, beyond simply preventing the other party from performing its contractual obligations, those duties also prohibited a party from doing anything to prevent other parties from receiving the benefit and entitlements of the agreement. The defendants argued that plaintiffs' view of the implied duties was incorrect, that plaintiffs had not alleged that PGRT prevented them from performing their contractual relations and that the implied duties did not require defendants to take any affirmative actions. According to the defendants, plaintiffs were only entitled to the liquidation preference under the terms of the Articles Supplementary and that they were attempting to rewrite those Articles to provide them with rights not present. The Court again agreed with the defendants, stating that shareholders were only entitled to the preferential rights contained in the applicable agreements between the parties. The Court held that the implied duties did not impose upon defendants any obligations to take any affirmative action for

² 1998 WL 778359 (Del. Ch. 1998).

³ 1999 WL 893575 (Del. Ch. 1999).

⁴ 1990 Del. Ch. LEXIS 19 (Del. Ch. 1990).

plaintiffs' benefit nor could the implied duties be relied upon to change the terms of a contract. Moreover, the Court stated, the fact that PGRT remained a going concern, that none of its actions demonstrated bad faith to the Court and that, if necessary, it was able to pay the liquidation preference if so ordered defeated plaintiffs' argument that PGRT had prevented plaintiffs from receiving the benefits and entitlements of their agreement.

Plaintiffs' third claim, a breach of fiduciary duty against Lightstone, was addressed next. Defendants argued that Maryland did not recognize a breach of fiduciary duty as an independent claim and that Lightstone, as a common shareholder of PGRT, owed no duty to the preferred shareholders in connection with the liquidation preference. Citing *Kann v. Kann*⁵, the Court indicated that there could be a claim for breach of fiduciary duty. Citing further to *Garcia v. Foulger Pratt Dev., Inc.*⁶, the Court stated that in order to prove such a claim, plaintiffs had to identify the particular fiduciary relationship involved and how it was breached, and consider and select the remedies available and appropriate. Plaintiffs asserted that Lightstone's position as the controlling shareholder created a fiduciary duty on Lightstone owed to the plaintiffs. They further asserted that Lightstone had used its position as the controlling common shareholder for its own benefit and offered several Maryland cases in support of their argument. The Court, however, distinguished those cases and pointed out that Lightstone owned common shares, not preferred shares. It held that because the rights of the preferred shareholders were governed by their shareholder agreement, Lightstone, as the controlling common shareholder, owed no duty to plaintiffs as a matter of law.

Finally, the Court addressed plaintiffs claim of unjust enrichment against Lightstone. Plaintiffs attempted to argue that Lightstone had caused PGRT to make the distributions to it at the expense of the preferred shareholders, thus forming the basis of the unjust enrichment claim. However, citing to *FLF, Inc. v. Wold Publ'ns, Inc.*⁷, the Court stated that Maryland law prohibited unjust enrichment claims when an express contract governed the underlying subject matter. In this case, the underlying subject matter was governed by the Articles Supplementary between PGRT and the plaintiffs. Lightstone was not a party to that contract, and despite its lack of privity thereto, that contract still governed the subject matter of plaintiffs' claim. Accordingly, the Court held that the plaintiffs could not maintain an unjust enrichment action against Lightstone as a matter of law.

Ultimately, the Court granted defendants' motion to dismiss the amended complaint with prejudice.

⁵ 344 Md. 689 (1997).

⁶ 155 Md. App. 634 (2003).

⁷ 99 F. Supp. 640 (D. Md. 1998).