Clerk of the Superior Court
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SUPERIOR COURT OF ARIZONA
MARICOPA COUNTY

CV 2016-016099 01/07/2019

HONORABLE DANIEL G. MARTIN

CLERK OF THE COURT
J. Eaton
Deputy

PARK PLAZA L L C, et al.

v.

SMITH PARTNERS @ 51 L L C, et al.

ROBERT A SHULL

ROBERT A ROYAL

BRADLEY A BURNS
AMANDA E NEWMAN
AMY D SELLS
JUDGE DANIEL MARTIN

UNDER ADVISEMENT RULING

Pending before the Court is Defendants Smith Partners @ 51, LLC f/k/a Smith Partners Domus, LLC ("Smith Partners"), Robert M. Levin as the (former) representative of the Estate of William Harris Smith ("Smith Estate"), @ 51 Partners Arizona, LLC f/k/a Domus Partners Arizona LLC ("@ 51 Partners" or the "Company"), and Harris Management, Ltd.'s ("Harris Management") (collectively "Defendants") June 19, 2018 Motion for Summary Judgment, Plaintiffs Park Plaza, LLC ("Park Plaza") and Murray Manaster's ("Manaster") (collectively "Plaintiffs") August 13, 2018 Response, and Defendants' September 7, 2018 Reply. The Court heard oral argument on December 14, 2018, at which time the matter was taken under advisement. Having now considered the arguments presented, and for the reasons set forth herein, the Court enters its ruling granting in part, and denying in part, Defendants' motion.

FACTUAL AND PROCEDURAL BACKGROUND

The Court adopts the following portions of Defendants' background statement as supported by the evidence and fairly providing an overview of the dispute at issue in this case:

This action arises out of a joint venture between Park Plaza and Smith Partners to develop real estate in Phoenix (the "Project"). The parties formed @ 51 Partners for the venture, and memorialized their understandings concerning the company in an Operating Agreement dated September 27, 2012. The Operating Agreement, as amended, is uncontested and controls this dispute.

In the Operating Agreement, the parties agreed that Park Plaza would contribute the land and Smith Partners would contribute capital to develop the land into an apartment complex with the ultimate goal of selling the Project. The sale proceeds would be distributed as provided in the Operating Agreement.

The parties also agreed in the Operating Agreement to designate Harris Management to manage @ 51 Partners. The Operating Agreement contained typical broad powers entrusted to the manager who had full and complete authority to manage the affairs of the company, enter into contracts, and sell the Project.

Smith Partners and Park Plaza executed a Second Amended Operating Agreement on February 7, 2014, in which the parties refined the distribution waterfall and agreed that Park Plaza would receive its share of sale proceeds only after Smith Partners received a defined return on its contribution. The Second Amended Operating Agreement also restructured the parties' agreement by (1) memorializing that Smith Partners caused Park Plaza's $2.0 million debt on the land to be paid in full; (2) reducing Park Plaza's Initial Capital Contribution to $1.7 million, representing the amount by which the value of the land exceeded the amount of the loan (*i.e.*, the equity); and (3) increasing Park Plaza's Percentage Interest in @ 51 Partners to 75%. Plaintiffs assert that on January 23, 2014, just prior to the execution of the Second Amended Operating Agreement, Mr. Smith told Murray Manaster in the presence of Mr. Manaster's attorney that Park Plaza would be paid $3.7 million, representing Park Plaza's investment plus a preferred return. Mr. Manaster's attorney, Shawn Tobin, participated in drafting the Second Amended Operating Agreement, but did not integrate Mr. Smith's alleged promise into the Agreement or any other writing. But for the testimony of Mr. Manaster and Mr. Tobin, there is no evidence, written or otherwise, corroborating Mr. Smith's alleged promise.

Per the Second Amended Operating Agreement, Park Plaza contributed the encumbered land to @ 51 Partners and Smith Partners obtained a $23 million construction loan.

> Mr. Smith unexpectedly passed away on June 18, 2016, and attorney Robert Levin was appointed Executor of the Bill Smith Estate. By that time, the Project was constructed and it was at least 80% leased. In furtherance of @ 51 Partners's business purpose, Mr. Smith had engaged Berkadia Real Estate Advisors to market and sell the Project. Mr. Levin continued the marketing and sale process through Berkadia until the Project was sold, closing on August 26, 2016. . . . The sale of the Project and distribution of sale proceeds was conducted in accordance with the Operating Agreement, as amended, but resulted in zero proceeds to Park Plaza.

Motion, at 1-3 (citations to Defendants' Separate Statement of Facts omitted).

On October 25, 2016, Plaintiffs filed a Complaint alleging breach of contract as to Smith Partners and Harris Management, breach of the covenant of good faith and fair dealing as to Smith Partners and Harris Management, breach of fiduciary duty as to Smith Partners and Harris Management, violations of the Illinois Limited Liability Company Act as to Smith Partners, Harris Management, the Company, and Mr. Levin, interference with contract or business expectancy as to the Company and Mr. Levin, negligent misrepresentation as to Smith Partners and the Smith Estate, and fraud as to Smith Partners and the Smith Estate.

On June 21, 2017, Plaintiffs filed an Amended Complaint alleging breach of contract as to Smith Partners and Harris Management, breach of the covenant of good faith and fair dealing as to Smith Partners and Harris Management, breach of fiduciary duty as to Smith Partners and Harris Management, violations of the Illinois Limited Liability Company Act as to Smith Partners, Harris Management, and the Company, interference with contract or business expectancy as to the Company and Mr. Levin, negligent misrepresentation as to Smith Partners and the Smith Estate, and fraud as to Smith Partners and the Smith Estate. It was to the allegations of this Amended Complaint that Defendants direct their arguments for summary judgment.[1]

After the briefing concluded on Defendants' motion for summary judgment, Plaintiffs filed a Second Amended Complaint. The Second Amended Complaint alleged claims for breach of contract as to Smith Partners, Harris Management, the Company, and the Smith Estate (now explicitly pleading a cause of action for breach of the alleged oral promise), breach of the covenant of good faith and fair dealing as to Smith Partners, Harris Management, the Company, and the Smith Estate (also explicitly pleading a cause of action for breach of the alleged oral promise), breach of fiduciary duty as to Smith Partners, Harris Management, the Company, and the Smith Estate (based in part on breach of the alleged oral promise), and violations of the Illinois Limited Liability Company Act as to Smith Partners, Harris Management, and the Company.

[1] After the motion was filed, upon stipulation of the parties, the Court dismissed Plaintiffs' claims for fraud and misrepresentation.

In their motion, Defendants seek summary judgment on Plaintiffs' claims for breach of contract as to Smith Partners and Harris Management, breach of the covenant of good faith and fair dealing as to Smith Partners and Harris Management, breach of fiduciary duty as to Smith Partners and Harris Management, and violations of the Illinois Limited Liability Company Act as to Smith Partners, Harris Management, and the Company. The matter of the alleged oral promise is not presently before the Court.

SUMMARY JUDGMENT STANDARD

A court may enter summary judgment only if "there is no genuine dispute as to any material fact and the moving party is entitled to judgment as a matter of law." Rule 56(a), Ariz. R. Civ. P. *See also Delmastro & Eells v. Taco Bell Corp.*, 228 Ariz. 134, 137-38, ¶ 7, 263 P. 3d 683, 686-87 (Ct. App. 2011). In deciding a motion for summary judgment, the Court must view the facts and the reasonable inferences to be drawn from those facts in the light most favorable to the non-moving party. *See, e.g., Espinoza v. Schulenburg*, 212 Ariz. 215, 216, ¶ 6, 129 P.3d 937, 938 (2006).

DISCUSSION

Choice of Law

Section 11.2 of the Operating Agreement provides:

> Application of Law. This Operating Agreement, and its interpretation, shall be governed exclusively by its terms and by the laws of the State of Illinois and specifically the Illinois Act, except to the extent that the Company shall be governed by the laws of the State of Arizona relating to the Land and the Arizona Act, if applicable, and except to the extent that the Company shall be governed by federal law.

Defendants' Statement of Facts ("DSOF"), Exhibit 3.

Defendants urge that because the terms of the Operating Agreement are not in dispute, Illinois law does not apply. Plaintiffs contend that Illinois law governs their claims for breaches of the Operating Agreement and fiduciary duties based in the Operating Agreement, as well as their claims for violations of the Illinois Limited Liability Company Act.

Plaintiffs are correct. To the extent the Complaint allegations are based on rights and obligations created by the Operating Agreement, the plain language of the Operating Agreement's

choice of law provision requires that such allegations be assessed under Illinois law. Accordingly, the Court will apply Illinois law to Plaintiffs' claims for breach of contract, breach of the covenant of good faith and fair dealing, breach of fiduciary duty, and violations of the Illinois Limited Liability Company Act.[2]

Section 10.5

Section 10.5 of the Operating Agreement provides:

> Return of Contribution Nonrecourse to Other Members. Except as provided by law or as expressly provided in this Operating Agreement, upon dissolution, each member shall look solely to the assets of the Company for the return of its Capital Contribution. If the Company property remaining after the payment or discharge of the debts and liabilities of the Company is insufficient to return the Capital Contribution of any Member, such Member shall have no recourse against any other Member, except as otherwise provided by law.

DSOF, Exhibit 3.

Defendants contend that because "the purpose of the Company – to develop and sell the Project – has been fulfilled . . . the Company is effectively dissolved." Motion, at 5 (citing *In re GR BURGR, LLC*, 2017 WL 3669511 (Del. Ch. Aug. 25, 2017)). From this premise, Defendants urge that to the extent insufficient assets remain to repay Park Plaza's capital contribution (as is in fact the case), Park Plaza may not seek to recover that contribution from Smith Partners.

Plaintiffs correctly respond that "[u]nder Defendants' construction of § 10.5, Defendants could just wrongfully distribute money and never have consequences even if @ 51 Partners had remaining unliquidated liability and even if there were direct claims against @ 51 Partners." Response, at 11. But more fundamentally, the Court concludes that Defendants' arguments under Section 10.5 are not ripe because dissolution has not yet occurred. Accordingly, summary judgment is not appropriate as to Smith Partners' liability under Section 10.5.

Breach of Contract and Breach of Covenant of Good Faith and Fair Dealing – Harris Management

Defendants urge that "Harris Management is not a party to the Operating Agreement, as amended, and cannot be liable for breaches thereof." Motion, at 6. Defendants further argue that

[2] Plaintiffs acknowledge that Arizona law would have applied to their claims for fraud and negligent misrepresentation, *see* Response, at 9 n.5, but in view of the dismissal of those claims, that acknowledgement is moot.

"[e]ven assuming *arguendo* that Harris Management is a party to the Operating Agreement . . ., Harris Management . . . complied with the express terms of §§ 5.17(b) and 8.4, and [is] therefore entitled to summary judgment on Plaintiffs' breach of contract claims." *Id*. The Court need not address the second contention, because Defendants are correct that Harris Management is not a party to the Operating Agreement.

The Operating Agreement states:

> THIS **OPERATING AGREEMENT** is entered into as of the 27th day of September 2012, by and among SMITH PARTNERS DOMUS LLC, an Illinois limited liability company ("**Smith Partners**") and PARK PLAZA, LLC, an Arizona limited liability company ("**Park Plaza**"), as set forth in the signature section hereof (sometimes collectively referred to herein as the "**Members**" and individually as a "**Member**").

DSOF, Exhibit 3 (emphasis in original). Likewise, the August 30, 2013 and February 7, 2014 amendments to the Operating Agreement are by and among Smith Partners and Park Plaza. *See* Plaintiffs' Statement of Facts, Exhibit F, and DSOF, Exhibit 4.

In their Response, Plaintiffs do not attempt to controvert what is plain and unambiguous from the written agreement between the parties. At oral argument, Plaintiffs suggested that Harris Management's signature on the Operating Agreement and its amendments raised a genuine issue of material fact, but the Court rejects this argument. The Operating Agreement is a contract between Smith Partners and Park Plaza only. Accordingly, Defendants are correct that Harris Management cannot be liable for its alleged breaches thereof. Further, as a non-party to the agreement, Harris Management cannot be liable for its alleged breach of the covenant of good faith and fair dealing.[3]

Breach of Contract and Breach of Covenant of Good Faith and Fair Dealing – Smith Partners

As to Smith Partners, Defendants assert that "[e]ven assuming *arguendo* that . . . Park Plaza is permitted to maintain a breach of contract claim against Smith Partners, . . . Smith Partners complied with the express terms of §§ 5.17(b) and 8.4, and [is] therefore entitled to summary judgment on Plaintiffs' breach of contract claims." Motion, at 6.

Section 5.17(b) provides:

[3] As discussed below, the Court's ruling on Harris Management's contractual liability does not end the inquiry, as Plaintiffs still have claims for breach of fiduciary duty and for violation of the Illinois Limited Liability Company Act.

> Actions Requiring Unanimous Consent of the Members. Notwithstanding anything herein to the contrary, the following actions shall require the unanimous consent of all of the Members:
>
> * * *
>
> (b) a sale of the Project in which the collective distribution would result in Park Plaza not receiving 100% of its Initial Capital Contribution, unless Smith Partners shall provide a verification of value from a third party appraiser or other mutually agreeable third party validating and/or confirming the sale value of the Project;

DSOF, Exhibit 3.

> Section 8.4 provides, in pertinent part:
>
> Limitations upon Distributions.
>
> (a) No distribution or return of Capital Contributions shall be made and paid if, after the distribution or return of Capital Contributions is made, either:
>
> (1) the Company would be insolvent; OR
> (2) the net assets of the Company would be less than zero.

DSOF, Exhibit 3.

The gravamen of Defendants' argument under Section 5.17(a) is that Smith Partners provided a verification of value to Park Plaza that validated the sale value of the property, and therefore that Park Plaza's consent to the sale was not required. *See* Motion, at 7-8. Plaintiffs respond that on the record presented, there are genuine issues of material fact as to "the propriety and accuracy of the made-to-order Appraisal obtained and then hidden from Plaintiffs" that preclude the entry of summary judgment. Response, at 12. Plaintiffs are correct. There are a myriad of factual issues surrounding the preparation and delivery of the appraisal that ultimately must be decided by a jury. *See, e.g.*, Response at 13. In view of this finding, summary judgment is not appropriate as to either Plaintiffs' claim for breach of contract or their claim for breach of the covenant of good faith and fair dealing.[4]

[4] Illinois recognizes a claim for breach of the covenant of good faith and fair dealing. *See McCleary v. Wells Fargo Securities, L.L.C.*, 29 N.E.3d 1087, 1093 (Ill. App. 2015).

Defendants' argument under Section 8.4 is that upon the distribution of proceeds from the sale of the Project, the Company was neither rendered insolvent nor did the net assets of the Company drop below zero. Accordingly, Smith Partners did not violate this provision. In response, Plaintiffs assert that there is a genuine issue of material fact as to whether, at the time of the distribution of proceeds, the Company had a "multi-million-dollar unsatisfied liability to Plaintiffs", *viz.*, the $3.7 million that was the subject of Mr. Smith's alleged oral promise. *See* Response, at 15.

The enforceability of the alleged oral promise is not a matter presently before the Court, inasmuch as Plaintiffs' allegations of fraud and misrepresentation based on that alleged promise have been withdrawn, and the direct allegations for breach of contract and breach of the covenant of good faith and fair dealing based on that alleged promise were not pleaded until the filing of the Second Amended Complaint, which occurred *after* the completion of briefing on Defendants' motion for summary judgment. In light of this somewhat unusual procedural posture, the Court will reserve judgment as to Defendants' claim under Section 8.4 pending a decision on the merits as to Plaintiffs' allegations regarding the oral promise. If the Court finds in Defendants' favor on the oral promise, Defendants may re-urge their motion as to Section 8.4.

Breach of Fiduciary Duty and Violation of
Illinois Limited Liability Company Act – Smith Partners

Under Illinois law, in a manager-managed company, "a member who is not also a manager owes no duties to the company or to the other members solely by reason of being a member", and "a member who exercises some or all of the authority of a manager and conduct of the company's business is held to the standards of conduct in subsections (b), (c), (d), and (e) of this Section." 805 Ill. Comp. Stat. Ann. 180/15-3(g)(1) & (3). Here, as Defendants correctly observe, the Operating Agreement "is silent as to any fiduciary duties owed by the members to each other." Motion, at 14. Accordingly, to the extent Smith Partners can be said to have a fiduciary duty towards Park Plaza, such duty must be based on evidence that Smith Partners "exercise[d] some or all of the authority of a manager and conduct of the company's business".

The Court agrees with Defendants that on the present record, there is no significant evidence that Smith Partners "exercise[d] some or all of the authority of a manager and conduct of the company's business". Plaintiffs urge that "Smith Partners owed fiduciary duties to Plaintiffs because Smith Partners and Harris Management were affiliated entities with common control, acted in concert regarding the Sale and the exclusion of Plaintiffs, and dominated Plaintiffs as to @ 51 Partners." Response, at 23 (referencing *Tully v. McLean*, 948 N.E.2d 714 (Ill App. 2011)). However, Plaintiffs fail to support this assertion with evidence sufficient to create a genuine issue of material fact. Plaintiffs further claim that Smith Partners exercised managerial authority (and

therefore assumed a fiduciary duty to Park Plaza) to the extent that Smith Partners provided the "verification of value" to Park Plaza under Section 5.17 of the Operating Agreement. That argument, however, fails because the Operating Agreement specifically authorized Smith Partners to provide the verification as an exception to the unanimous consent provision.

In the absence of evidence demonstrating that Smith Partners owed a fiduciary duty to Park Plaza, summary judgment is appropriate on Plaintiffs' claims against Smith Partners for breach of fiduciary duty and violation of the Illinois Limited Liability Company Act.

Breach of Fiduciary Duty and Violation of
Illinois Limited Liability Company Act – Harris Management

Section 5.4 of the Operating Agreement provides:

> Liability for Certain Acts. The Manager shall perform the duties of the manager in good faith, in a manner the Manager reasonably believes to be in the best interests of the Company, and with such care as an ordinarily prudent person in a like position would use under similar circumstances. The Manager shall have such fiduciary obligations as required by law. The manager shall not be liable to the Company or to any Member for any loss or damage sustained by the Company or any Member, unless loss or damage shall have been the result of fraud, deceit, gross negligence or willful misconduct by the Manager.

DSOF, Exhibit 3.

Under Illinois law, in a manager-managed company, "a manager is held to the same standards of conduct prescribed for members in subsections (b), (c), (d), and (e) of this Section". 805 Ill. Comp. Stat. Ann. 180/15-3(g). Those subsections provide:

> (b) A member's duty of loyalty to a member-managed company and its other members includes the following:
> (1) to account to the company and to hold as trustee for it any property, profit, or benefit derived by the member in the conduct or winding up of the company's business or derived from a use by the member of the company's property, including the appropriation of a company's opportunity;
> (2) to act fairly when a member deals with the company in the conduct or winding up of the company's business as or on behalf of a party having an interest adverse to the company; and
> (3) to refrain from competing with the company in the conduct of the company's business before the dissolution of the company.

> (c) A member's duty of care to a member-managed company and its other members in the conduct of and winding up of the company's business is limited to refraining from engaging in grossly negligent or reckless conduct, intentional misconduct, or a knowing violation of law.
> (d) A member shall discharge his or her duties to a member-managed company and its other members under this Act or under the operating agreement and exercise any rights consistent with the obligation of good faith and fair dealing.
> (e) A member of a member-managed company does not violate a duty or obligation under this Act or under the operating agreement merely because the member's conduct furthers the member's own interest.

Id.

As can be seen from the Illinois statute, Harris Management is obligated by Illinois law to act fairly, to refrain from engaging in grossly negligent or reckless conduct, intentional misconduct, or a knowing violation of law, and to exercise its authority "consistent with the obligation of good faith and fair dealing." Defendants urge that Harris Management exercised its business judgment in good faith under the terms of the Operating Agreement; however, the Court agrees with Plaintiffs that on the record presented, the question of whether Harris Management exercised its authority reasonably under the circumstances is a matter for the jury. Accordingly, summary judgment is not appropriate.

Violation of Illinois Limited Liability Company Act – @ 51 Partners

As Defendants correctly observe in their motion, the Illinois Limited Liability Company Act "does not impose fiduciary duties upon the entity in which a plaintiff is an owner." Motion, at 16. Plaintiffs do not argue otherwise in their Response. Summary judgment is appropriate as to this claim.

DISPOSITION

IT IS ORDERED denying Defendants' motion for summary judgment that Smith Partners has no liability to Park Plaza under Section 10.5 of the Operating Agreement.

IT IS ORDERED granting Defendants' motion for summary judgment as to Plaintiffs' claims against Harris Management for breach of contract and breach of the covenant of good faith and fair dealing.

IT IS ORDERED denying Defendants' motion for summary judgment as to Plaintiffs' claims against Smith Partners for breach of contract and breach of the covenant of good faith and

fair dealing, without prejudice to Defendants' ability to re-urge Smith Partners' claim under Section 8.4 as provided herein.

IT IS ORDERED granting Defendants' motion for summary judgment as to Plaintiffs' claims against Smith Partners for breach of fiduciary duty and violation of the Illinois Limited Liability Company Act.

IT IS ORDERED denying Defendants' motion for summary judgment as to Plaintiffs' claims against Harris Management for breach of fiduciary duty and violation of the Illinois Limited Liability Company Act.

IT IS ORDERED granting Defendants' motion for summary judgment as to Plaintiffs' claims against @ 51 Partners for violation of the Illinois Limited Liability Company Act.