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Transaction ID 60312181
Case No. 2017-0178-

IN THE COURT OF CHANCERY OF THE STATE OF DELAWARE

RCS CREDITOR TRUST,

Plaintiff,

v.

NICHOLAS S. SCHORSCH; EDWARD M. WEIL, JR.; WILLIAM KAHANE; PETER M. BUDKO; BRIAN S. BLOCK; LOUISA QUARTO; RCAP HOLDINGS LLC; AR CAPITAL, LLC; AR GLOBAL INVESTMENTS, LLC; AMERICAN REALTY CAPITAL RETAIL ADVISOR, LLC; AMERICAN FINANCE ADVISORS, LLC; AMERICAN REALTY CAPITAL HEALTHCARE III ADVISORS, LLC; AMERICAN REALTY CAPITAL HOSPITALITY ADVISORS, LLC; NEW YORK CITY ADVISORS, LLC; GLOBAL NET LEASE ADVISORS, LLC; AMERICAN REALTY CAPITAL HEALTHCARE II ADVISORS, LLC; NEW YORK RECOVERY ADVISORS, LLC; and BDCA ADVISER, LLC,

Defendants.

C.A. No. __________

VERIFIED COMPLAINT

RCS Creditor Trust (the "Trust"), by and through its attorneys, Kramer Levin Naftalis & Frankel LLP and Ashby & Geddes, alleges as follows:

NATURE OF THE ACTION

1. This action seeks to recover losses resulting from a scheme by Nicholas Schorsch and his colleagues to exploit their de facto control of a public company, RCAP, to enrich their wholly owned fund management business called AR Capital, to the ruinous detriment of RCAP and its innocent stakeholders. Schorsch and his colleagues, referred to here as the "Control Defendants," created RCAP and owed it fiduciary duties as officers, directors, and controlling shareholders.[1] The Control Defendants raised hundreds of millions of dollars in public stakeholder investments, then caused RCAP to operate unprofitably for AR Capital's benefit and to make boldly imprudent investments that served only AR Capital's interests. This abuse, together with the foreseeable impact of financial fraud they perpetrated at an affiliated entity, was so severe that after less than three years RCAP declared bankruptcy – having lost nearly $1 billion in investors' money. As a result, stockholder value has been wiped out, and creditors owed

[1] The "Control Defendants" include Schorsch and co-defendants Edward Weil, William Kahane, Peter Budko, and Brian Block, who at all relevant times acted under Schorsch's control and at his direction.

more than $250 million stand to collect little beyond the proceeds of this litigation. Meanwhile, the defendants have collected and continue to reap hundreds of millions of dollars in ongoing fees all resulting from investments procured by RCAP. A large portion of those profits fairly belongs to RCAP.

2. The Control Defendants became immensely wealthy creating and running non-traded investment vehicles, mostly REITs, for sale to moderately affluent individuals. In the web of Schorsch-related entities, AR Capital, LLC ("AR Capital") was the product manufacturer, creating and managing these REITs, while RCS Capital Corporation ("RCAP") provided and supported the sales force necessary to feed AR Capital with an ongoing stream of new investments. Without RCAP to bring in the money, AR Capital would be nothing. Because the Control Defendants ran both companies, but had a far greater financial interest in AR Capital (which they wholly own) than in RCAP (where they owned approximately 25% on a fully diluted basis), they had a built-in motivation to skew contract terms and transactions in favor of AR Capital.

3. Despite this inherent conflict of interest, no steps were taken to put disinterested managers or directors in charge of RCAP. To the contrary, the Control Defendants exercised virtually unfettered power, which they exploited to loot RCAP for AR Capital's benefit by shifting the cost of raising investments to RCAP, while keeping virtually all of the profits generated by those investments for

themselves. This conduct breached defendants' core duties of loyalty and good faith – ultimately leading to RCAP's destruction.

4. The key to understanding the defendants' scheme lies in the economic structure of the non-traded REIT business. AR Capital's fund sponsorship and management business is extremely lucrative, generating fees based on a percentage of all assets under management every year, together with a share of the managed funds' profits and generous transaction fees. But as with all profitable businesses, there are related costs – primarily based on the need to drum up a steady flow of investments for these funds. This is accomplished through an arduous wholesale marketing process and then retail sales directly to the principal consumers: "mass affluent" investors with between $100,000 and $1 million in liquid assets and annual income over $75,000. Moreover, because these investments are not listed on any exchange ("non-traded") and hence illiquid, substantial and costly compliance, legal, and regulatory obligations are imposed on the distribution process.

5. FINRA rules limit the fees that can be charged in connection with selling interests in REITS to 10% of the investment amount, 7% of which is typically allocated to the investment advisor to incentivize them to put their clients into these investments and another 1% to 2% of which is typically allocated to the retail broker-dealer who has agreed to carry the product on its platform. The 1% to

2% that remains as compensation for the wholesale broker-dealer is not enough to generate a reasonable profit as a freestanding business even in the best of circumstances. As a result, REITs are usually marketed by "captive" wholesale divisions owned by the sponsors. Within an integrated company, the costs of wholesaling are absorbed as part of a profitable business. In the rare situation where wholesale operations are separate from the REIT sponsor and advisor, the entity that owns the wholesale broker-dealer customarily demands and receives a role in the far more profitable servicing and advisory end of the business – referred to here as the "management economics." That is the only way the wholesaler can turn a decent profit given the costs of the regulatory and sales process.

6. The Control Defendants originally established and operated their own captive wholesale broker-dealer known as Realty Capital Securities ("RCS" or "Wholesale"), as part of an integrated company. So long as Wholesale was part of AR Capital, it was irrelevant how profits were split between it and the entities conducting the more lucrative sponsorship and advisory businesses. But in 2013, Schorsch and his colleagues concocted a scheme to push the cost of raising investments to other parties: They spun off Wholesale (together with two other small business units) in subsidiaries of a new holding company, RCAP, and then divested the majority of their economic stake in that new entity by selling most of RCAP to public investors. Defendants thus forced the public stakeholders of

RCAP to shoulder much of the costs associated with the profitable REIT business without getting what an independent company would have demanded in an arm's-length negotiation: a piece of the management economics.

7. Although RCAP later acquired a retail broker-dealer business and promised to focus expansion on that potentially profitable line, the Control Defendants caused RCAP to pour increasing resources into Wholesale and other ancillary business lines to benefit AR Capital at RCAP's expense. All of these decisions were made by interested officers and directors loyal to Schorsch, with none of the traditional safeguards to insure the fairness of interested party transactions. This abusive course of conduct caused RCAP to suffer massive losses from its launch in 2013 until Wholesale was ultimately abandoned for no value on the eve of bankruptcy in late 2015.

8. RCAP's business suffered further injury in November 2014 when Schorsch and his colleagues were implicated in a major accounting fraud scandal at American Realty Capital Properties ("ARCP"), a publicly traded REIT that the Control Defendants had founded and still controlled. The disclosure that ARCP had fraudulently overstated its profitability sent shockwaves throughout the REIT industry, tainting all AR Capital products and all Schorsch-related businesses. Most immediately, RCAP was forced to pay ARCP $60 million to back out of an agreement to buy ARCP's "Cole Capital" wholesale and advisory

business – a transaction that RCAP's independent directors would never have approved if they had known that ARCP was being investigated for fraud. The Control Defendants breached their fiduciary duty to RCAP by concealing that fraud.

9. In an attempt to cleanse their crown jewel, AR Capital, of the ongoing taint of the ARCP fraud, in 2015 the Control Defendants tried to sell a 60% stake in AR Capital to Apollo Global Management ("Apollo"), one of the nation's largest private equity firms, for total consideration that could have approached $900 million. As part of this deal, Schorsch tried to force RCAP to sell its failing wholesale business for $20 million – subsequently reduced to $6 million before the deal and Wholesale itself were finally abandoned completely. Schorsch continuously blocked efforts by the independent directors to negotiate superior deals with third parties to avoid bankruptcy and preserve value for creditors. And to pave the way for the proposed Apollo transaction the Control Defendants caused Wholesale employees to engage in flagrant proxy fraud – including by assuming fake accents to impersonate investors supposedly consenting to measures needed to consummate the Apollo/AR Capital transaction. This misconduct led to a December 2015 consent order with Massachusetts securities regulators imposing a $3 million fine and barring RCS from doing business in that state (by then a virtually moot point).

10. Thus, as further detailed below, the Control Defendants injured RCAP by:

- Causing it to enter into **off-market arrangements** to distribute AR Capital products without the customary share of the management economics – siphoning tens, if not hundreds, of millions of dollars of profits from RCAP.

- Forcing RCAP to **irrationally overstaff** the Wholesale business in order to maximize sales volume regardless of cost, imposing further losses on RCAP.

- **Perpetrating and concealing the ARCP fraud**, and then causing RCAP to enter into the **doomed Cole Capital transaction,** resulting in RCAP having to pay $60 million to settle litigation over its withdrawal from the transaction and otherwise injuring RCAP's ongoing business.

- Causing RCAP to enter into **irrational transactions** to serve AR Capital's interests, including

  (a) acquiring Strategic Capital Partners LLC ("Strat Cap"), another wholesaler, at an inflated price;

  (b) purchasing a law firm with the putative but futile goal of creating a "research" department ("SK Research") within RCAP to produce reports on non-traded investment products, forcing RCAP to incur costs with no tangible benefit to anyone other than AR Capital (which wanted to silence a persistent critic of its business practices); and

  (c) acquiring Docupace Technologies ("Docupace"), a small technology company tasked to develop software to facilitate sales of AR Capital products – shifting yet another cost center to RCAP's public investors.

- **Blocking any non-Apollo transaction**, thereby preventing RCAP's independent directors from developing competing proposals to provide urgently needed new capital to allow RCAP to restructure.

- Engaging in **<u>proxy fraud</u>** to facilitate the AR Capital/Apollo transaction, resulting in sanctions that destroyed whatever value remained in RCAP's wholesale business.

11. As a consequence of this abuse, RCAP struggled from the moment it went public in 2013, took a nosedive following disclosure of the ARCP fraud, and ended up in bankruptcy in early 2016 – even as the Control Defendants' fund sponsorship and management businesses generated ever-increasing profits. Over its barely two and one-half year existence, RCAP raised more than $20 billion in investments in AR Capital funds, producing at least $200 million in annual fees for defendants and attracting a suitor willing to invest upwards of $900 million for a 60% stake, at the same time that RCAP – the engine of those profits – spiraled downward. The Control Defendants are still reaping the benefits, as they continue to manage more than $18 billion in assets, all resulting from investments raised by Wholesale.

12. Ultimately, most of RCAP's businesses were divested for nominal amounts and the remaining retail broker-dealer business, renamed Aretec, was reorganized in bankruptcy and handed over to secured lenders. Unsecured creditors were left holding the bag – dependent mainly on this litigation for any meaningful recovery.

13. The actions set forth in this complaint constitute egregious breaches of the fiduciary duties of loyalty and care the Control Defendants and

defendant Louisa Quarto owed as officers, directors, and/or controlling shareholders of RCAP, including the duties not to usurp corporate opportunities and waste corporate assets. The Control Defendants are liable for participating in and (to the extent any are found not to have owed fiduciary duties at any particular time) for aiding and abetting these breaches of duty. In addition, AR Capital and its wholly-owned advisory and management entities (the "Advisor Defendants") were unjustly enriched by the Control Defendants' wrongdoing and should be made to disgorge their unfairly enhanced profits.

PARTIES

14. Plaintiff RCS Creditor Trust (the "Trust") was established under the Fourth Amended Joint Plan of Reorganization for RCS Capital Corporation and its Affiliated Debtors Under Chapter 11 of the Bankruptcy Code (the "Plan"), as confirmed by the United States Bankruptcy Court for the District of Delaware by Order dated May 19, 2016 (the "Confirmation Order"). Pursuant to the Plan and Confirmation Order, the Trust has been assigned certain claims and causes of action held by the Debtors or their estates, including those asserted in this action:

> [The Trust] shall retain and may enforce, sue on, settle, or compromise (or decline to do any of the foregoing) all Claims, rights, Causes of Action, suits, and proceedings, whether in law or in equity, whether known or unknown . . . against any Person without the approval of the

> Bankruptcy Court and the Reorganized Debtors' and the Creditor Trust's rights to commence, prosecute, or settle such Causes of Action shall be preserved notwithstanding the occurrence of the Effective Date, subject to the terms of Section 7.2 of the Plans, this Confirmation Order and any contract, instrument, release, Convertible Notes Indenture, or other agreement entered into in connection with the Plans.

Confirmation Order ¶ 31 at 63.

15. RCAP, a predecessor-in-interest to the RCS Creditor Trust, was a Delaware corporation with its principal place of business in New York, New York. In 2012, the Control Defendants, along with AR Capital, assembled their wholesale broker-dealer, investment banking, transfer agency, and transaction management companies under RCAP as a holding company. On June 5, 2013, RCAP successfully launched its initial public offering and listed on the New York Stock Exchange under ticker "RCAP." On January 31, 2016 (the "Petition Date"), RCAP together with various subsidiaries commenced a voluntary case under Chapter 11 of the Bankruptcy Code. As of the Petition Date, RCAP had approximately 77.3 million Class A common stock shares outstanding, all wiped out for no value under the Plan.

16. Defendant RCAP Holdings LLC ("Holdings") is a Delaware limited liability company, with its principal place of business in New York, New York. Holdings' principal asset was the single outstanding share of RCAP's Class

B common stock (the "B Share"), which had the same economic rights as a share of Class A common stock but voted as 50% plus one vote of the outstanding common stock of the Company. Holdings was, therefore, a controlling shareholder of RCAP and itself at all times controlled by the Control Defendants.

17. Defendant Nicholas S. Schorsch ("Schorsch") is an individual with his principal place of business in New York, New York. Until his resignation on December 30, 2014, he served as the Executive Chairman of RCAP's Board of Directors. Schorsch is also the Chairman, Chief Executive Officer, co-founder, and, through his 56.02% membership interest, controlling owner of AR Capital. (Schorsch's wife, Shelly D. Schorsch, owns an additional 7.54% of AR Capital.) On information and belief, Schorsch has a similar ownership interest in Holdings. In addition, Schorsch served as the Chief Executive Officer of American Realty Capital Partners ("ARCP," now known as "VEREIT") from 2010 until October 1, 2014.

18. Defendant William M. Kahane ("Kahane") is an individual with his principal place of business in New York, New York. Kahane served as RCAP's original Chief Executive Officer until he resigned from that position on September 21, 2014. Kahane also served on the RCAP Board of Directors until his resignation on December 30, 2014, and on the ARCP Board of Directors until June 24, 2014. Kahane is a co-founder of AR Capital and holds a 13.5% membership

interest. On information and belief, Kahane has a similar ownership interest in Holdings. Kahane has served on the boards of directors of many AR Capital sponsored REITs.

19. Defendant Edward M. Weil, Jr. ("Weil") is an individual with his principal place of business in New York, New York. Weil was at all relevant times a member of the RCAP Board of Directors, and served as the Chief Executive Officer of RCAP from September 22, 2014, until November 17, 2015. Weil also served as President and Chief Operating Officer of AR Capital and has served as President, Chief Operating Officer, Executive Vice President, Director, and Treasurer of ARCP at various intervals from 2012 through 2014. Weil holds a 3.51% membership interest in AR Capital. On information and belief, Weil has a similar ownership interest in Holdings. Weil has served as an officer, and on the boards of directors of many AR Capital sponsored REITs.

20. Defendant Peter M. Budko ("Budko") is an individual with his principal place of business in New York, New York. Budko at all relevant times was a member of the RCAP Board of Directors, as well as the Executive Vice President and Chief Investment Officer of AR Capital. He also served as the Chief Investment Officer and Executive Vice President at ARCP from 2010 to 2014. Budko holds a 16.4% membership interest in AR Capital. On information and

belief, Budko has a similar ownership interest in Holdings. Budko has served as an officer, and on the boards of directors of many AR Capital sponsored REITs.

21. Defendant Brian S. Block ("Block") is an individual with his principal place of business in New York, New York. Block served as a director and Chief Financial Officer of RCAP from February 2013 until July 2014. Block is a co-owner, and has served as Executive Vice President and Chief Financial Officer of, AR Capital. As of June 2014, Block held a 3.03% membership interest in AR Capital and, on information and belief, a similar ownership interest in Holdings. Block served as Chief Financial Officer and Executive Vice President of ARCP from its formation in December 2010 and was appointed Treasurer and Secretary in December 2013. Block was asked to resign from ARCP on October 28, 2014. Block is currently under indictment for conspiracy and securities fraud in the United States District Court for the Southern District of New York; his trial is scheduled for May 2017.

22. Schorsch, Weil, Kahane, Budko, and Block are collectively referred to herein as the "Control Defendants."

23. Defendant Louisa Quarto ("Quarto") is an individual with her principal place of business in New York, New York. From January 2012 through January 2016, Quarto served as President of RCS. During the same time period she simultaneously served as Executive Vice President of AR Capital, and she

continues to serve as Executive Vice President of AR Global Investments LLC to this day. At all relevant times Quarto has been economically dependent on, acted at the direction of, and given her undivided loyalty to, the Control Defendants.

24. Defendant AR Capital LLC ("AR Capital") is a Delaware limited liability company with its principal place of business in New York, New York that sponsors and manages non-traded investment vehicles. Defendant AR Global Investments LLC, also a Delaware limited liability company with its principal place of business in New York, New York, is publicly held out as "the successor to AR Capital's business" and is functionally identical to AR Capital; accordingly, both entities are referred to herein collectively as "AR Capital." AR Capital is the largest creator and sponsor of REITs in the United States. A REIT is a corporation that owns real estate assets and has certain tax benefits under the Internal Revenue Code. To be deemed a REIT and entitled to the federal tax benefits, the entity must, among other requirements, transfer at least 90 percent of annual taxable income to investors. AR Capital's non-traded REIT offerings are sector-specific and consist of healthcare, hospitality, grocery anchored retail, real estate debt, anchored core retail, global sale-leaseback, and New York office and retail real estate. AR Capital was unjustly enriched by the Control Defendants' wrongdoing.

25. AR Capital operates its business through a complex web of subsidiaries. Generally, for each REIT or other investment vehicle it sponsors, AR Capital maintains a number of wholly owned entities. While the nature and function of these entities varies from vehicle to vehicle, for every AR Capital fund a separate entity is created to provide management services pursuant to an advisory agreement. As explained in detail below, while the terms of these advisory agreements vary they are invariably lucrative to the advisor entities, which have no employees and provide the required services entirely through employees of AR Capital and related entities. Each of the following entities – collectively referred to as the "Advisor Defendants" – was unjustly enriched at RCAP's expense by the wrongdoing of the Control Defendants. On information and belief, each Advisor Defendant is a Delaware limited liability company with its principal place of business in New York, New York.

(a) Pursuant to an Advisory Agreement dated March 17, 2011, as subsequently amended, Defendant American Realty Capital Retail Advisor, LLC provides advisory services to American Realty Capital Retail Centers of America Inc. in exchange for annual management fees, acquisition fees, incentive fees, and other valuable forms of compensation (together, "Advisory Compensation").

(b) Pursuant to an Advisory Agreement dated April 4, 2013, as subsequently amended, Defendant American Finance Advisors, LLC, formerly known as American Realty Capital Trust V, LLC, provides advisory services to American Finance Trust, LLC, in exchange for Advisory Compensation.

(c) Pursuant to an Advisory Agreement dated August 20, 2014, as subsequently amended, Defendant American Realty Capital Healthcare III Advisors, LLC provides advisory services to American Realty Capital Healthcare Trust III, Inc. in exchange for Advisory Compensation.

(d) Pursuant to an Advisory Agreement dated January 7, 2014, as subsequently amended, Defendant American Realty Capital Hospitality Advisors, LLC provides advisory services to American Realty Capital Hospitality Trust, Inc. in exchange for Advisory Compensation.

(e) Pursuant to an Advisory Agreement dated June 25, 2015, as subsequently amended, Defendant New York City Advisors, LLC provides advisory services to American Realty Capital New York City REIT, Inc. in exchange for Advisory Compensation.

(f) Pursuant to an Advisory Agreement dated July 15, 2013, as subsequently amended, Defendant Global Net Lease Advisors, LLC, formerly American Realty Capital Global Advisors, LLC, provides advisory services to Global Net Lease Inc., formerly known as American Realty Global Trust Inc., in exchange for Advisory Compensation.

(g) Pursuant to an Advisory Agreement dated March, 11, 2013, as subsequently amended, Defendant American Realty Capital Healthcare II Advisors, LLC provides advisory services to Healthcare Trust Inc., formerly American Realty Capital Healthcare Trust II, Inc., in exchange for Advisory Compensation.

(h) Pursuant to an Advisory Agreement dated February 17, 2010, as subsequently amended up through December 19th, 2016, Defendant New York Recovery Advisors, LLC provided advisory services to New York REIT, Inc. in exchange for Advisory Compensation.

(i) Pursuant to an Advisory Agreement dated October 28, 2010, as subsequently amended, Defendant BDCA Adviser provides advisory services to Business Development Corporation of America in exchange for Advisory Compensation.

26. American Realty Capital Properties, Inc. ("ARCP") (now known as "VEREIT"), not a party to this action, is a publicly traded REIT that Schorsch created and controlled until his abrupt resignation in December 2014 amid accusations of intentional accounting misstatements and a subsequent cover-up.

FACTUAL ALLEGATIONS

I. SCHORSCH CREATED A NON-TRADED EMPIRE AND TOOK RCAP PUBLIC

27. After a career running his father's scrap metal business that ended with the U.S. Secretary of Labor assessing more than $40,000 in fines for intentionally exposing his employees to lead poisoning, Schorsch amassed his initial wealth in the 1990s by acquiring soon-to-close bank branches at bargain prices and then re-leasing them to other banks. In 2002, Schorsch formed a REIT with his bank branches and, in 2003, took the company public, raising $800 million in the offering. The public company, American Financial Realty Trust, went on an acquisition binge, buying up bank branches, call centers, office buildings, and similar assets. By 2006, with the company plagued by liquidity issues and poor performance, Schorsch was forced out (with a $21.6 million severance package) and the company was sold a year later at a 33% loss to investors over a time period in which the Morgan Stanley REIT Index rose 94%.

28. With money made from the American Financial Realty Trust venture (despite investors' losses), Schorsch and defendant Kahane founded AR Capital in 2007 to enter the business of non-traded REITs. Defendants Weil, Budko, and Block were soon added to the team and given ownership interests in AR Capital. At all relevant times, Messrs. Kahane, Weil, Budko, and Block have

done Schorsch's bidding, acting at his direction and control – and have been compensated handsomely for so doing.

29. In 2008, these five AR Capital partners pooled their resources to create Wholesale to distribute AR Capital-managed products. At first AR Capital and Wholesale were unprofitable. The financial crisis of 2008 made the sale of illiquid private securities impossible. With no investments, AR Capital had no revenue, and Wholesale was shouldering the fixed cost of a large sales force. But by 2009 and 2010 demand for real estate investment products had rebounded, and Wholesale was one of the few wholesalers left standing. With Wholesale as the dominant distribution platform, AR Capital quickly became the market leader in the non-traded REIT space.

30. From 2010 to 2012, Schorsch and the other Control Defendants continued to grow their non-traded REIT empire, launching many funds across various hard asset classes, in each case with Wholesale selling the AR Capital-sponsored products. The enterprise was generating significant profits but the Control Defendants were unsatisfied, and soon created a method to make the REIT business even more lucrative by off-loading a key part of their expenses on third parties while retaining all of the profit.

31. In December 2012, RCAP was formed as a holding company owning the following three operating subsidiaries: (i) Wholesale; (ii) RCS

Advisory Services, LLC ("RCS Advisory"), an investment banking and capital markets business that also provided transaction management services to direct investment programs and their sponsors; and (iii) American National Stock Transfer, LLC ("ANST"), a registered transfer agent that acted as registrar and transfer agent for direct investment programs and registered investment companies sponsored, co-sponsored, or advised by RCAP's affiliated companies (primarily the AR Capital-sponsored non-traded REITs). RCS Advisory and ANST, though profitable, accounted for only approximately 3% of RCAP's overall revenues ($6.8 million of $218.6 million in revenues, according to the initial prospectus). In essence, RCAP was created to off-load the cost-heavy Wholesale business.

32. While RCAP was a distinct legal entity by 2012, the Control Defendants still owned 100% of RCAP and thus any decisions taken at RCAP to benefit AR Capital were inconsequential. As long as the Control Defendants did not borrow funds or sell a stake in RCAP, the profits and losses of AR Capital and RCAP were fungible – defendants would be moving money from one pocket to another.

33. As the next step in their scheme, however, in June 2013 the Control Defendants sold a stake in RCAP to public investors, thus creating the opportunity for self-dealing. Following the IPO, defendants now had third-party resources at RCAP to dedicate toward growing AR Capital. From this point on,

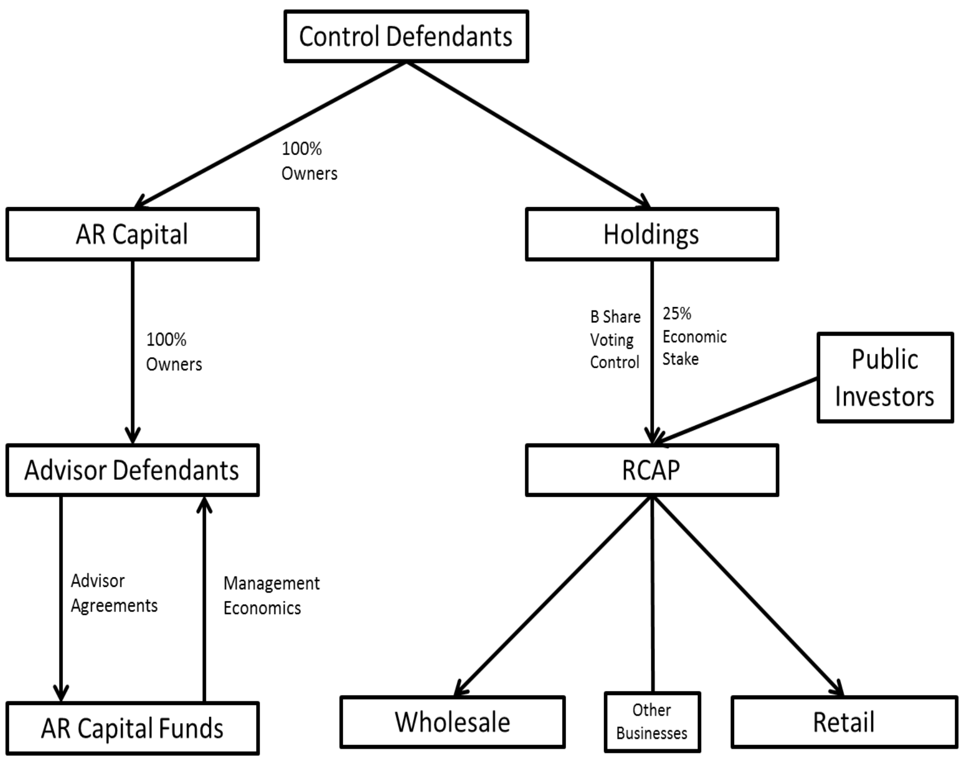
they could shift expenses to RCAP to make public stakeholders shoulder the costs associated with raising investments for their funds, while keeping the golden goose – the management economics – all to themselves.

34. In the spring of 2014, RCAP began to acquire a network of retail broker-dealers, led by the April 2014 acquisition of Cetera Financial Holdings LLC ("Cetera") for approximately $1.1 billion. Cetera is a leading financial services company formed in 2010 that provides independent broker-dealer services and investment advisory services. Cetera provides access to financial products, compliance, legal and technical support, and custody and clearing functions for a network of thousands of investment advisors across the country. Along with other complex investment products, Cetera's advisors have access to non-traded REIT investments approved by Cetera for purchase by their "mass affluent" retail investors. The Cetera acquisition was financed through senior convertible notes, senior secured loans, convertible preferred stock, and common equity.

35. Five weeks after the Cetera acquisition, RCAP raised $385 million through another offering of common stock, at $20.25 per share. The proceeds of that stock offering were earmarked to finance the closing of some smaller acquisitions that were committed but not closed, as well as for future acquisitions in the independent retail broker-dealer space to build on Cetera's

business (together with Cetera, "Retail"). Through Holdings, the Control Defendants simultaneously sold five million shares of their own stock to the public and pocketed more than $100 million, far more than fully recouping all investments they had made in the business.

36. The chart below provides a simplified overview of the ownership structure of AR Capital and RCAP and its various subsidiaries following consummation of the secondary public offering in 2014:



37. As shown in this chart, after these transactions the Control Defendants had managed to reduce their economic stake in RCAP from over 90% to approximately 25% on a fully diluted basis, while maintaining complete control

over RCAP because they retained (through Holdings) a “B Share” that was guaranteed to retain majority voting power.

38. The Control Defendants used their control of RCAP to appoint managers with deep ties and loyalty to the Schorsch empire, rather than seasoned industry veterans with public company experience. In fact, each of the individual defendants has at one time been an officer or director of RCAP. Schorsch himself was RCAP’s Chairman before being forced to resign after he was implicated in the ARCP accounting fraud, as discussed further below. Kahane and Weil both served as RCAP’s CEO. Budko and Block were directors at RCAP, and Block – the primary perpetrator of the ARCP fraud – served as CFO. A subsequent CFO, Brian Jones, was a paid employee of AR Capital. And Louisa Quarto at all relevant times served simultaneously as President of Wholesale and Executive Vice President of AR Capital. In short, RCAP management consisted of AR Capital insiders loyal to Schorsch. Yet no mechanisms were put in place to assure that decisions involving the interests of both companies were made by disinterested officers and directors.

39. There is no dispute that Schorsch and the other Control Defendants effectively controlled both RCAP Holdings and RCAP itself. As explained in RCAP’s December 31, 2014 Form 10-K:

> For so long as any of our Class B common stock remains outstanding, the holders of our Class B common stock always will have a majority of the voting power of our outstanding common stock. This concentrated control will limit or preclude your ability to influence corporate matters as a holder of Class A common stock. RCAP Holdings — which is directly or indirectly controlled by Messrs. Schorsch and Kahane — holds the sole outstanding share of our Class B common stock and thereby controls a majority of the voting power of our outstanding common stock, retains effective control of our board of directors and has the ability to control all matters submitted to our stockholders for approval.
>
> . . . .
>
> Due to their control over the sole outstanding share of Class B common stock, Messrs. Schorsch and Kahane currently have the ability to control or influence all matters affecting us, including:
>
> - the composition of our board of directors and, through our board of directors, any determination with respect to our business plans and policies;
>
> - any determinations with respect to mergers, acquisitions and other business combinations;
>
> - our acquisition or disposition of assets;
>
> . . . . [and]
>
> - corporate opportunities that may be suitable for us, RCAP Holdings or Messrs. Schorsch and Kahane and the other members of RCAP Holdings[.]

RCS Capital Corp., Annual Report (Form10-K) (March 10, 2015) at 33.

40. This structure created an inherent potential for conflicts, which was exacerbated by the basic economics of the REITs that the Control Defendants controlled.

II. RCAP'S STRUCTURE CREATED INHERENT CONFLICTS

41. After the acquisition of Cetera and a number of additional smaller independent broker-dealers, RCAP consisted mainly of two businesses: Retail (Cetera and other smaller broker-dealers) and Wholesale (RCS). (RCAP owned several other small businesses that did not provide significant ongoing contributions to the company's profitability.) Retail, while it did offer AR Capital-sponsored products to its network of over 9,500 financial advisors, derived most of its value from business lines and products unaffiliated with AR Capital. Wholesale, however, received the vast majority of its revenue from transactions with AR Capital. As explained more fully below, Wholesale was structurally limited to a 1% to 2% fee, and could not provide a reasonable return on investment if operated as a standalone business. But Wholesale was a necessary part of the REIT pipeline and therefore critical to AR Capital's profits.

42. After the Cetera acquisition, RCAP's management repeatedly assured public investors of its intent to grow its retail broker-dealer business and deemphasize its related-party Wholesale business. In a February 26, 2014 interview, approximately a month after announcing the Cetera acquisition, Schorsch represented that "[w]e're directly focused on retail," adding that he intended to purchase a Registered Investment Advisor, a family office, and "perhaps some more independent broker-dealers." During an August 7, 2014

earnings call, Kahane emphasized that "[w]e continue to focus on growth opportunities for the Retail Advice segment."

43. In fact, the Control Defendants caused RCAP to move in the exact opposite direction. Instead of following their publicly avowed strategy of building up the potentially profitable Retail business, they caused RCAP to pour resources into the inherently unprofitable (for RCAP) Wholesale business. This strategy was pursued solely for the benefit of AR Capital, by moving the maximum amount of its product while shifting most of the marketing cost to RCAP. Defendants' corrupt focus on Wholesale at the expense of building Retail resulted in disastrous consequences for RCAP.

III. THE ECONOMICS OF THE NON-TRADED REIT BUSINESS CREATED INHERENT CONFLICTS

44. The conflict of interest exploited by the Control Defendants is based on the economics of the non-traded REIT industry. AR Capital creates investment vehicles, typically by purchasing hard assets such as real estate, which are placed into a tax advantaged REIT or BDC (for "Business Development Company") structure. It then oversees the fund – obtaining debt financing; buying, selling, and managing assets; and ultimately deciding when and how to sell the business, take it public, or wind it down. For these services, provided through a variety of wholly owned "advisor" and "manager" entities – here named as the

Advisor Defendants – AR Capital is compensated handsomely. This compensation comes in the form of ongoing asset management fees, typically equal to a percentage (around 1%) of assets under management, or fixed annual fees of similar magnitude; asset acquisition and disposition fees; substantial bonuses upon consummation of a "liquidity event" (such as selling the REIT or taking it public); and various forms of profit sharing sometimes referred to as a "promote." A typical promote might give AR Capital, through its advisor subsidiary, 15% of the REIT's annual profits above 6%.

45. Wholesale, in turn, was assigned the arduous task of raising all the money to fund AR Capital's operation – by marketing the AR Capital products to retail broker-dealers and, ultimately, to financial advisors who would then sell the product to their "mass affluent" retail clients. RCAP distributed 100% of AR Capital's products. AR Capital was thus dependent upon RCAP for its growth and survival. AR Capital was and is a volume business: The more AR Capital product RCAP distributed to retail investors, the more fees AR Capital would earn and the more valuable it became.

46. Each step of the marketing process is labor-intensive, involving extensive "schmoozing," entertaining, and hard selling, but the fee structure for non-traded REITs limits the total compensation that can be paid to the various parties involved in this initial investment process. Under FINRA Rule 3210, total

sales commissions and expenses cannot exceed 10% of the investment amount. Typically, this 10% "load" is split, with 7% devoted to incentivizing the financial advisor and 3% "allowed" to the wholesale broker-dealer, of which 1% to 2% is paid as "reallowance" to the retail broker-dealer.

47. But even wholesalers who manage to keep a full 2% load cannot achieve reasonable profitably as standalone businesses, and there are no historic examples of any company having successfully done so. The majority of the commission flows as compensation to the individual wholesale salesperson, leaving only a fraction to cover company expenses, such as lavish RCAP-sponsored conferences for investment advisors and travel and entertainment budgets for salespeople. In light of the inherent unprofitability of this portion of the business, wholesalers must either: (a) function as a cost center within a larger vertically integrated organization, or (b) negotiate for a share of the ongoing management economics generated by the investments they raise, either through a joint venture interest in the advisory, or through advisor/subadvisor contractual relationship with the sponsor.

48. While Wholesale started off as a money-losing or marginally profitable cost center within AR Capital, when the Control Defendants spun it off into RCAP they off-loaded the costs of marketing to public stakeholders – while

keeping all the profits at AR Capital, an arrangement no third party wholesaler negotiating on an arms'-length basis would accept.

49. One telling example of the terms that a third party wholesale broker-dealer would demand and obtain in a true arm's length negotiation is found in the experience of Strategic Capital Partners LLC ("Strat Cap"), an independent wholesale distributor acquired by RCAP in 2014. Whenever Strat Cap's wholesale broker-dealer subsidiary entered into a dealer-manager agreement for a non-traded REIT, Strat Cap would simultaneously negotiate to receive either an ownership stake in, or a "sub-advisory agreement" with, the REIT's external advisor, entitling it to receive 20% to 25% of the advisory fees. Wholesale should have been permitted to bargain for a similar slice of the management economics. Not so with Wholesale, which "agreed" to market all of AR Capital's product merely for a sliver of the 3% sales commission load – and did so only because it was dominated and controlled by the Control Defendants. Indeed, the word "agreed" is placed in quotations because there is not the slightest indication that any semblance of negotiation occurred: the Control Defendants simply set the terms, which were never even presented to the Board let alone considered and approved by disinterested directors.

50. The Control Defendants understood the bargaining power of an independent wholesaler – and had in fact exploited it in at least two business

arrangements with another REIT sponsor, Phillips Edison & Company, a real estate investor with an expertise in grocery-anchored shopping centers. In 2010, Phillips Edison launched the Phillips Edison Grocery Center REIT I ("PECO I"). Lacking its own wholesale distribution capability, Phillips Edison approached the Control Defendants to retain Wholesale – then a wholly owned subsidiary of AR Capital – as dealer-manager. In return, the Control defendants bargained for Phillips Edison to give another AR Capital subsidiary (American Realty Capital Advisors II LLC, or "ARC Advisor") a share of the ongoing Management Economics. This was accomplished by having the REIT contract with ARC Advisor to serve as the fund's nominal advisor, with a Phillips Edison-owned entity serving as sub-advisor ("PECO Sub"). ARC Advisor, though technically responsible for certain decisions, "delegated most of its duties, including managing [the] day-to-day operations, identifying and negotiating investments on [the REIT's] behalf and providing asset management services" to the PECO Sub, "an entity whose management team has the experience to identify, acquire and manage the assets" the REIT intended to acquire. Phillips Edison Grocery Center REIT I Prospectus Statement, dated August 20, 2010. While Phillips Edison, through PECO advisor, did essentially all of the substantive work, 22.5% of the "promote" went to the Control Defendants, through ARC Advisor – a fair market deal strikingly similar to what Strat Cap customarily negotiated.

51. Three years later, virtually the same transaction structure was duplicated when Phillips Edison launched a new REIT, called Phillips Edison Grocery Center II ("PECO II"), with a Prospectus dated November 25, 2013. This time Wholesale was part of a public company, RCAP, but it still received only the inadequate compensation provided under the dealer-manager agreement; the Control Defendants diverted to themselves the piece of the ongoing management economics for which Wholesale otherwise could have bargained if managed by independent fiduciaries – assigning it to a new AR Capital subsidiary called American Realty Capital PECO II Advisors. To be clear, AR Capital performed no actual services for PECO II; it passively collected a share of the management economics as a price for causing Wholesale to provide its services. This is a clear demonstration of the fair market terms for providing third-party wholesale services, and AR Capital's retention of the slice of management economics was a brazen usurpation of RCAP's corporate opportunity.

52. The Control Defendants' disloyal treatment of RCAP was strikingly illustrated in late 2014 when, as a result of the sudden toxicity of the ARC name due to the ARCP fraud, the Phillips Edison REITs' independent boards understandably terminated the nominal advisor agreements with the AR Capital advisor subsidiaries, and removed all trace of AR Capital from the fund names. Remarkably, negotiations with Phillips Edison over these efforts were conducted

on AR Capital's behalf by Wholesale attorneys and led by Wholesale President Louisa Quarto. But instead of representing Wholesale's interests, they fought for the AR Capital entity to receive its pro rata share of the promote under the restructured deal. Quarto insisted that AR Capital should retain "our" share of the management economics – with "our" referring to the Control Defendants to whom she was loyal. Quarto gave no mind to RCAP's independent interests, in connection with these terminations or, more importantly, when the Control Defendants acted to usurp the management economics for themselves in the first place. Unfortunately, this rank disloyalty was not an aberration but business as usual for Schorsch and his cronies.

IV. THE CONTROL DEFENDANTS ABUSED RCAP TO MAXIMIZE PROFITS AT AR CAPITAL

53. The conflict inherent in the AR Capital/RCAP corporate structure should have been addressed by placing RCAP in the hands of independent officers and directors who could deal with AR Capital at arm's length, or at least by having disinterested directors review and pass on the fairness of transactions affecting both companies. Neither of these customary safeguards was employed. Instead, Schorsch and his associates ran both companies for their own benefit – openly embracing and exploiting the conflict of interest and treating RCAP as a piggy bank for AR Capital. They staffed RCAP with officers and

directors loyal to Schorsch, who used their positions to shift costs to RCAP by, among other things, imposing non-market terms on the wholesale business, requiring RCAP to maintain irrationally high staffing to maximize its capacity to move AR Capital product, and pushing RCAP into inappropriate and unwise transactions to serve AR Capital's interests. These transactions were often entered into without due care or appropriate focus on and consideration of RCAP's interests.

A. The Control Defendants Caused RCAP to Distribute AR Capital Product on Off-Market and Unprofitable Terms

54. The Control Defendants breached their fiduciary duty to RCAP from its inception, when they transferred existing dealer-manager agreements that obligated Wholesale to distribute AR Capital product without receiving any share of the ongoing management economics. At the time of its creation, RCAP's board of directors did not include any independent directors, and no measures were taken to ensure that RCAP's business arrangements with AR Capital and other Schorsch-related entities were fair to RCAP. To the contrary, the Control Defendants and defendant Quarto, whom Schorsch had installed as President of Wholesale, knew the arrangements were off-market, and failed to disclose and indeed affirmatively hid that information from the independent directors in connection with new transactions. While independent directors were added to the RCAP board of

directors in early 2013 in preparation for taking the company public, existing and new business arrangements (including periodic renewals and amendments of existing contracts) between RCAP and other Schorsch entities were never reviewed or passed upon by these newly-installed independent directors.

55. For example, on October 3, 2013, when the Control Defendants were contemplating the Strat Cap acquisition, a Wholesale employee e-mailed an overview of Strat Cap's business to Weil and Quarto. This slide deck described the economic deals Strat Cap had negotiated with the REITs it distributed: In every case, in addition to the standard (legally constrained) 3% dealer-manager fees, Strat Cap also received between 20% and 25% of the ongoing management economics – either through an interest in the entities created to provide advisory services or through a "sub-advisory" contract. Although this information was crucial to an understanding of Strat Cap's business model – and precisely because it would shed light on the off-market nature of RCAP's existing business arrangements with AR Capital – it was excluded from the single slide deck provided to the RCAP Board of Directors to obtain their written consent to the Strat Cap acquisition on October 23, 2013.

56. Lead RCAP independent director Mark Auerbach has testified that it was not until the Strat Cap acquisition was completed, and the Board began receiving information about Strat Cap's revenue stream, that the independent

directors became aware that RCAP's deals with AR Capital were off-market – and that the Control Defendants appeared to be perfectly satisfied with this unfair arrangement:

> [Wholesale] raised capital for – for the wholesale operation, raised capital for entities developed and controlled by AR Capital. That was our wholesale operation. We received fees for doing so. It wasn't until we acquired [Strat Cap] that we realized that [Strat Cap], who did the same thing for third parties, not only got the same fees, but they got a piece of the management companies that created value. And every time I brought that up with Mike Weil or with Nick, I got a smile as contrasted to looking into it.

57. The independent directors were nevertheless powerless to remedy the abuse of RCAP in light of the Control Defendants' total domination and control – through majority control of the Board of Directors, supermajority voting control of the common stock, and the installation of loyal officers running Wholesale. Every one of Wholesale's business deals with RCAP was negotiated and agreed to on both sides – to the extent "negotiation" could be said to have occurred – by the Control Defendants and their minions. The arrangements were never presented to the Board of Directors for approval. Each instance in which the Control Defendants caused RCAP to assume (when the public company was first formed), enter into, or renew these off-market and ultimately disastrous agreements represented a distinct breach of their fiduciary duties.

B. The Control Defendants Forced RCAP to Overstaff Wholesale to Sell More AR Capital Product

58. Driven to maximize RCAP's capacity to sell AR Capital product, the Control Defendants further exploited their control over RCAP to cause it to maintain an irrational and unsustainable staffing level for the Wholesale business, even as that business cratered in the wake of the ARCP fraud. Rather than appropriately downsizing – or completely shedding – Wholesale as it hemorrhaged money, the Control Defendants made it lean into the punch, caring little about the inevitable pain this would cause RCAP because the Control Defendants would get continuing benefits from even modest additional sales of AR Capital products. While Schorsch then tried to depict RCAP's wholesale losses as the unavoidable consequence of an unforeseen market downturn in the non-traded space, RCAP's own numbers do not support that story.

59. The table below shows the publicly disclosed quarterly figures for Wholesale from 2012 until the June 2013 IPO of RCAP. (No public numbers exist prior to 2012.) The June 2013 IPO is the first time the Control Defendants took third-party funds in RCAP, giving rise to the incentive to self-deal.

	Wholesale Pre-IPO Performance					
	3/31/12	6/30/12	9/30/12	12/31/12	3/30/13	6/30/13
Revenue ($MM)	36.1	79.5	106.8	64.2	211.8	220.8
Pre-Tax Income ($MM)	(2.2)	1.2	11.6	(3.2)	22.9	23.9
% Margin	-6.0%	1.5%	10.9%	-5.0%	10.8%	10.8%
Equity raised ($BN)	0.3	0.9	1.3	0.5	2.2	2.3

60. If the publicly disclosed figures (which were provided to investors as part of the IPO and have not been verified) are accurate, from 2012 through June 2013, while the Control Defendants owned 100% of RCAP, Wholesale was modestly profitable when it raised $1 billion or more of equity in a given quarter. The story told to sell public stakes in the business was that this profitability could be expected to increase as the business grew even further, particularly as Wholesale began selling third-party product. This did not come to pass. To the contrary, Wholesale's profitability plummeted in the quarters after the Control Defendants sold a stake to outside investors in 2013, remaining mostly in the red regardless of how much it raised:

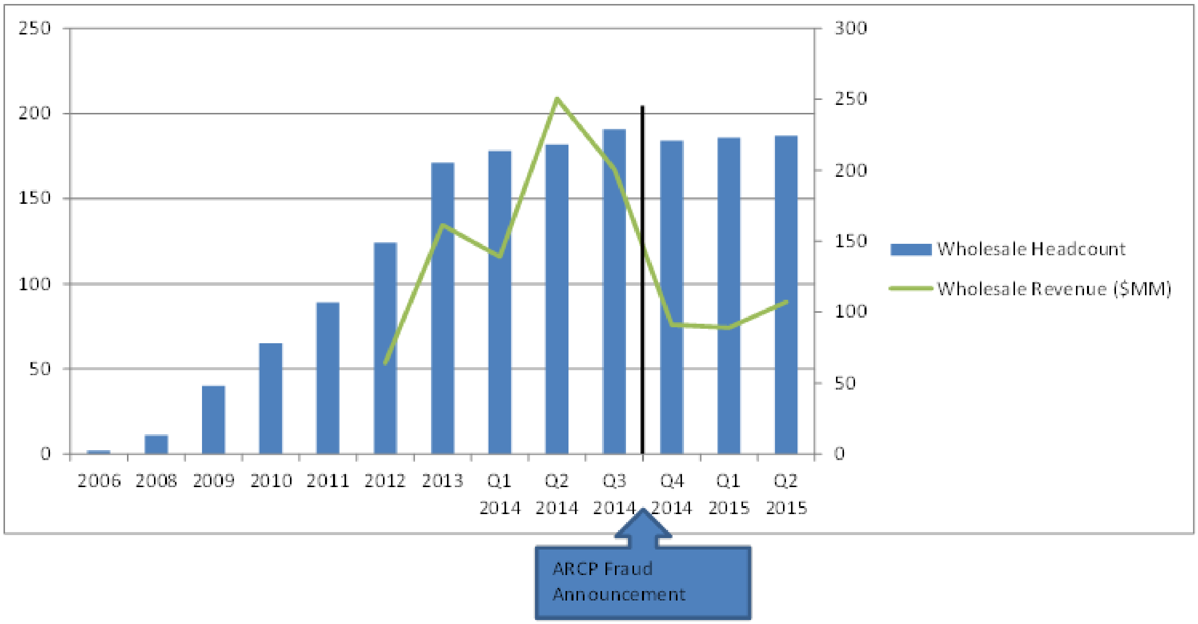
	Wholesale Post-IPO Performance							
	9/30/13	12/31/13	3/31/14	6/30/14	9/30/14	12/31/14	3/31/15	6/30/15
Revenue ($MM)	208.9	161.4	139.1	250.6	200.7	91.2	89.1	107.2
Pre-Tax Income ($MM)	4.9	(6.5)	(3.5)	4.5	(4.7)	(17.0)	(16.7)	(14.4)
% Margin	2.3%	-4.0%	-2.5%	1.8%	-2.3%	-18.6%	-18.7%	-13.4%
Equity raised ($BN)	2.4	1.8	1.6	2.6	2.1	0.8	0.8	1.0

61. After the Control Defendants sold a stake in RCAP, the business was barely profitable (and at times unprofitable) even when it raised $2 billion or more in a quarter and absolutely hemorrhaged cash when equity raised was closer to $1 billion. Moreover, these results actually overstate Wholesale's profitability, because they fail to recognize intercompany reallowance obligations arising from sales of product through RCAP's retail broker-dealer division as an expense associated with Wholesale's business. If properly analyzed as a

standalone business that must share part of the dealer-manager fees with the retail broker-dealer regardless of whether it is an affiliate, Wholesale's results would be even worse.

62. One reason for the discrepancy between Wholesale's pre- and post-IPO performance is that when the Control Defendants owned 100% of RCAP they were incentivized to run Wholesale rationally, at a size and compensation structure that closely resembled the actual demand for AR Capital's products. Once their ownership stake in RCAP was diluted, however, the Control Defendants chose to swing for the fences, perpetually over-staffing and over-compensating wholesalers in an attempt to push as much AR Capital product through the system as possible – regardless of the mounting losses, since the majority of those losses were borne by RCAP's public shareholders, not AR Capital.

63. Thus, Wholesale dramatically increased its staffing upon going public and stubbornly maintained the same high staffing levels despite declining profitability, the disastrous impact of disclosure of the ARCP fraud, and indeed until virtually the eve of shuttering the business in late 2015. Wholesale was organized around highly compensated external wholesalers supported by internal wholesalers, business development personnel, and product managers. The table below shows the high level of staffing that Wholesale rapidly built up and then maintained after RCAP's IPO, even as Wholesale revenues plummeted:



64. As the foregoing chart shows, Wholesale grew dramatically up to 2013 and maintained its staffing at 190 to 200 employees between December 2013 and August 2015. Even as the Wholesale business was dying throughout 2015, with devastating losses that ultimately drove RCAP into bankruptcy, the Control Defendants refused to reduce staffing. Significant cuts at Wholesale did not occur until November and December 2015, when it was already shutting down. Maintaining these staffing levels as losses mounted was utterly irrational for RCAP – it made sense only for AR Capital, which bore none of the costs but benefitted from having available the maximum capacity to push product. Responsible independent management would have started trimming staff at least by late 2014, when it was clear that Wholesale was losing money despite raising large amounts of equity.

65. RCAP's management was well aware of the problem. In July 2014 defendant Quarto, President of Wholesale, was presented with a risk assessment showing that Wholesale had far more salespeople than their nearest competitors, which should have rung alarm bells about Wholesale's staffing practices. The assessment also revealed that Wholesale was hosting too many large events to attract business, without focusing on basic cost management. Yet RCAP management continued to spend increasingly scarce corporate assets on Wholesale to drive sales of AR Capital product.

66. The situation became so dire that in November 2014 Cetera management told RCAP CEO Weil that RCAP would become insolvent by June 2015 if Wholesale losses were not stabilized. Disloyal management did not care. Correspondence involving Weil and Wholesale CEO Bill Dwyer from October and December 2014 reveals a single-minded focus on driving total sales through expenditures on client events, compensation incentives based on sales volumes, and hiring additional personnel – with little discussion about right-sizing a business that was rapidly losing money.

67. There simply was no incentive for the Control Defendants to be realistic in staffing and compensating Wholesale. Even after the devastating effects of the ARCP fraud (described below), more salespeople spending more money produced more sales, albeit at a dramatically slower pace; at that pace each

salesperson could not possibly produce enough revenue even to cover RCAP's costs, but every sale represented enduring benefits for AR Capital that the Control Defendants would keep for themselves.

C. Schorsch Concealed the ARCP Fraud, Forcing RCAP to Pay $60 Million to Terminate the Cole Capital Deal and Inflicting Ongoing Harm to RCAP's Business

68. Schorsch further injured RCAP by having it enter into an ill-fated deal in October 2014 to purchase a related-party business from ARCP for $700 million, despite being aware that the seller was in the midst of an investigation that would, four weeks after the signing of the transaction agreement, result in public disclosure of a massive accounting fraud known to and concealed by Schorsch and other Control Defendants. That announcement and its aftermath, including a Justice Department indictment, sent shock waves through all Schorsch-related businesses; wrecked the market for all AR Capital products; and required RCAP to pay $60 million to extricate itself from the now-disastrous transaction. RCAP never recovered from the harm inflicted by this scandal.

69. In the fall of 2014, Schorsch orchestrated the proposed sale to RCAP of Cole Capital Partners, LLC, and Cole Capital Advisors, Inc., along with certain subsidiaries (together, "Cole Capital") from ARCP – a publicly traded REIT then controlled by the Control Defendants. At the time, Schorsch was the

CEO and Chairman of ARCP, as well as Chairman of RCAP's Board of Directors, and thus was squarely on both sides of the transaction.

70. Cole Capital was initially a subsidiary of Cole Real Estate Investment, Inc. ("Cole"), a publicly listed company, and became a subsidiary of ARCP after ARCP merged with Cole in February 2014. That merger created the largest publicly traded company in the business of owning "triple-net lease" properties (where the tenant is responsible for essentially all costs associated with the property). Besides owning properties, the companies comprising Cole also included a captive wholesale distributor of non-traded REITs managed by Cole (similar to Wholesale), and the manager of the REITs (similar to AR Capital) – these businesses together being referred to as "Cole Capital." Public investors interested in owning ARCP for the triple net real estate properties pressured ARCP to divest Cole Capital. Because sale to a competitor could have disrupted AR Capital's dominant position in the non-traded REIT market, the Control Defendants were motivated to orchestrate a sale to RCAP.

71. On September 30, 2014, Schorsch and other Control Defendants caused RCAP to enter into an Equity Purchase Agreement pursuant to which RCAP agreed to purchase all of ARCP's interest in Cole Capital for $700 million, plus contingent consideration. The purchase price of $700 million consisted of (i) $200 million of cash, (ii) at RCAP's discretion, either $200 million

in cash or a calculated amount of RCAP Class A common stock, and (iii) an unsecured promissory note of RCAP in the aggregate principal amount of $300 million. Senior officers of RCAP informed Weil that "we have no way to pay for this," and outside investors loudly protested the transaction; all were ignored.

72. The self-serving nature of the transaction was obvious: It was a massive investment in business lines the company had previously represented it was deemphasizing, but would have benefitted AR Capital by expanding RCAP's wholesale capacity to form a distribution team with had a combined share of nearly 50% of the non-traded investment market.

73. The Control Defendants were able to engage in this egregious self-dealing by flouting corporate governance standards. Though it was a related party transaction, there was never any attempt to create a special committee of independent directors to evaluate the proposal. Independent legal and financial advisors were not hired to evaluate the proposed transaction. Instead, law firms which had repeatedly represented Schorsch businesses were retained and stood on both sides of the deal. While Schorsch nominally recused himself from formal discussions of the transaction, he continued to sit on the RCAP Board and was continuously involved through his loyal partners Kahane, Budko, and Weil. Schorsch regularly participated in discussions about the negotiations; helped create the information and materials presented to the RCAP Board on the transaction's

purported benefits, risks, and projected EBITDA; and directed what information should be released to the public. Schorsch and Kahane dismissed concerns repeatedly voiced by RCAP employees about undue speed and lack of adequate due diligence as the transaction hurtled forward.

74. Even more stunning, when the RCAP/Cole Capital agreement was signed Schorsch and other Control Defendants knew that the seller, ARCP, was in the midst of an internal accounting investigation resulting from intentional accounting errors. Less than a month later, on October 29, 2014, ARCP filed a Form 8-K Current Report disclosing that on the basis of information that came to its attention *on September 7, 2014*, its Audit Committee had hired the accounting firm of Ernst & Young to conduct an internal investigation, and that based on the investigation's preliminary findings, ARCP's previously issued audited consolidated financial statements and other information contained in its December 31, 2013, March 31, 2014, and June 30, 2014 public filings and other communications for those periods "should no longer be relied upon."

75. The disclosed misstatements consisted of an intentional inflation of ARCP's adjusted funds from operations ("AFFO") by including adjustments to AFFO related to interests that did not belong to ARCP. AFFO is often considered the most useful indicator of a REIT's ongoing performance and ability to pay dividends. Starting in the fourth quarter of 2013, the company

suddenly, without justification, and without disclosure changed the methodology it used in calculating AFFO for purposes of its public filings: It began adding back in the entirety, rather than only the company's pro rata share, of certain costs that are excluded from AFFO. In addition, the company changed the starting point for its AFFO calculation from "net" to "gross" – a change that made it more difficult for investors to understand the AFFO miscalculation.

76. These undisclosed and unjustified changes prevented investors from understanding ARCP's actual results and allowed ARCP to avoid revealing its actual faltering financial performance. Materially inflating AFFO allowed ARCP to continue accessing capital markets and financing its own acquisition spree, thereby enabling Schorsch and other senior ARCP insiders to reap hundreds of millions of dollars in inflated fees, commissions, and other compensation.

77. The investigation determined that ARCP's former Chief Financial Officer Brian Block (who was also a member of AR Capital and former director and CFO of RCAP) and former Chief Accounting Officer Lisa P. McAlister had "key roles" in creating the misleading financial statements. The two allegedly devised a scheme to cover up the accounting misstatements by adding false amounts as a "plug" to several figures in an internal spreadsheet that ARCP used to calculate AFFO. By using these plug numbers, ARCP concealed from its investors that it had overstated its AFFO per share. Without these overstatements,

ARCP would not have met analysts' consensus projections. Block and McAlister were both forced to resign in connection with the October 29, 2014, disclosure, and both were ultimately indicted. McAlister has pled guilty and is cooperating with federal prosecutors.

78. McAlister, however, has maintained that she was made a scapegoat in retaliation for whistle-blowing. In a verified defamation complaint filed shortly after she was terminated, McAlister asserted under oath that "beginning in or about February 2014" she "repeatedly informed Mr. Schorsch" about ARCP's accounting irregularities; that Schorsch nonetheless directed ARCP to continue using improper accounting methodology; and indeed that Schorsch took further steps to cover up the fraud in ARCP's Form 10-Q quarterly report for the second quarter. While McAlister subsequently withdrew this complaint without prejudice, she has never disavowed these sworn statements.

79. It thus appears that Schorsch and other Control Defendants knew about (and helped cover up) the accounting irregularities – and, at minimum, failed to disclose the ongoing investigation when they caused RCAP to enter into the imprudent acquisition agreement on September 30, 2014. In fact, on September 17, 2014, AR Capital Vice President Ori Kravel e-mailed RCAP's in-house counsel with a "direct instruction" from defendant Kahane to "pare down" due diligence requests to "**only** include items that are absolutely necessary."

(Emphasis in original). As a result, RCAP eliminated a standard and obviously important request that ARCP "[d]escribe any prior, pending, or threatened litigation, disputes, fines, sanctions, grievances, and/or audits involving [ARCP] or any of its equityholders, directors, officers, employees or other affiliated persons or entities, including any investigations or inquiries by regulators."

80. The failure to disclose the existence of the ARCP accounting fraud before committing RCAP to the Cole Capital transaction breached the most fundamental fiduciary duties owed by Schorsch and any other Control Defendant who knew of the fraud. It also violated RCAP's Code of Business Conduct and Ethics, which was enacted and approved by the RCAP Board of Directors on May 25, 2013, in connection with becoming a public company. That Code expressly states that all employees, officers and directors who know of any illegal or unethical conduct "have a duty to report it immediately."

81. The disclosure of the ARCP fraud on October 29, 2014 was a cataclysmic event that mortally wounded Wholesale and launched RCAP on a downward spiral towards bankruptcy – just as it devastated and tainted every business associated with Schorsch and AR Capital's REITS. On the day of the disclosure, RCAP's stock declined by 14% – and kept declining in the following days, closing down 17% for the week. Schorsch was forced to step down as ARCP's Chair in mid-December and resigned as RCAP Chair two weeks later.

82. The announcement immediately forced the RCAP Board to reconsider the wisdom of the Cole Capital transaction. While the accounting fraud as disclosed at that time did not involve misstatement of the financial results of the business RCAP had agreed to acquire, the implications of the fraud – including the irreparable reputational injury to all associated businesses – was clear. Cole Capital's business largely consisted of distributing and managing REIT products; disclosure of the accounting fraud called into question the basic value and reliability of anything emanating from ARCP. As Weil himself admitted to investors during a November 17, 2014, conference call, "there was no question in my mind, when [ARCP] announced that their financials were no longer reliable, they would definitely have some concern in their selling group about bleed over into their nontraded REITs. So we [had agreed to buy] a business based on projections" that were no longer realistic.

83. After discussions with RCAP management and consultation with legal counsel, a committee of independent Board members – only now did the Control Defendants finally recognize the need for such fundamental corporate governance – determined that it would be imprudent to proceed with the Cole Capital transaction. On November 3, 2014, RCAP wrote to ARCP terminating the Equity Purchase Agreement. ARCP responded by suing RCAP in the Delaware Court of Chancery seeking specific performance of the Agreement. Unfortunately,

at Schorsch's direction the hastily negotiated agreement did not include standard provisions allowing for termination upon occurrence of a "material adverse event" – which the ARCP disclosure certainly would have triggered. RCAP therefore had to base its termination on asserted breaches of representations and warranties by ARCP, allegations that ARCP contested. Following an investigation and on advice of counsel, RCAP agreed in December 2014 to pay ARCP $60 million to unwind the transaction and resolve the litigation.

84. While the Cole Capital fiasco was disastrous for RCAP – a dead loss of $60 million – it could have been far worse. If the transaction had closed, RCAP would have paid $400 million in cash and stock, and assumed $300 million in debt, for a business that rapidly evaporated in value after the fraud was disclosed.

85. If made aware of the fraud investigation, non-conflicted board members and management obviously would never have allowed RCAP to enter into the Cole Capital transaction in the first place. The Control Defendants committed an egregious breach of fiduciary duty in concealing the accounting fraud and causing RCAP to enter into the transaction over the objection of senior managers – and this breach of duty caused, at a minimum, $60 million in direct and utterly unnecessary harm.

86. Unfortunately, the ARCP fraud was still more broadly disastrous for RCAP. As noted above, all businesses related to Schorsch were dramatically and irrevocably injured by the disclosure that he had been implicated in financial wrongdoing and forced to resign from leadership positions. The revelation of overstated income at a REIT created and managed by Schorsch directly called into question the integrity of the very products created by AR Capital and exclusively sold by Wholesale. Myriad prominent brokerage firms promptly announced that they were suspending sales of all AR Capital products. As of November 24, 2014, 68 separate broker-dealer firms had suspended a total of 271 selling agreements with Wholesale. Approximately 25 of these firms each had more than $15 million in annual sales of Wholesale-distributed product. Investors recognized that a pervasive injury had been inflicted; RCAP's stock price continued to fall even after the Cole Capital transaction was terminated and the concomitant litigation was settled, sinking from $16.42 on October 31, 2014 to $9.51 on December 1, 2014.

87. Not surprisingly, and as reflected in the chart contained in paragraph 60 above, RCAP's wholesale business declined dramatically beginning in the fourth quarter of 2014. From the moment the ARCP fraud was disclosed, Wholesale's business persistently hemorrhaged money, racking up losses at an average rate of more than $15 million per quarter until the business was ultimately

dissolved on the eve of bankruptcy one year later. All of these impacts were a foreseeable result of the misconduct and cover-up in which Control Defendants participated and acquiesced at ARCP.

88. In public statements, the Control Defendants have ascribed the collapse of the Wholesale business to a purported general downturn in the market for nontraded investment products. This misleadingly confuses the cause with the effect. It is true that sales of REITs and similar investments dropped precipitously in 2015, following the ARCP disclosure, but the lion's share of that decline was directly attributable to Schorsch: In the first half of 2015, industry sales of REITs and BDCs were $7.4 billion, a decline of $4 billion, or 35%, from the same period in 2014. But *62%* of that decline – $2.5 billion – came from AR Capital products. Excluding AR Capital, the rest of the industry experienced only a 21% decline – and much of that was doubtless attributable to the ARCP fraud's impact on the non-traded market as a whole.

D. The Control Defendants Caused RCAP to Purse Imprudent Acquisitions to Serve AR Capital's Competitive Goals

89. The Control Defendants further harmed RCAP by causing it to pursue several unwise acquisitions that each served only AR Capital's interests; was approved by conflicted fiduciaries; and ended badly for RCAP.

1. <u>Strat Cap</u>

90. As noted above, RCAP agreed in May 2014 to purchase Strategic Capital Partners LLC ("Strat Cap"), a wholesale distributor of non-traded products which competed with AR Capital. The Strat Cap acquisition, which closed on September 2, 2014, represented an expansion of the very line of business – wholesale – that RCAP was telling investors it was deemphasizing. But the transaction served several interests of the Control Defendants, including (1) reducing competition with AR Capital's products by eliminating an independent wholesaler that had facilitated distribution of smaller, non-traded funds; and (2) opening up new lines of distribution for AR Capital products by providing access to national, full-service broker-dealers, known colloquially as "wire houses."

91. Coveting access to the wire houses, Schorsch had been trying for years to convince the owners of Strat Cap to sell to him. Only after RCAP went public and he was using the public stakeholders' pocketbook was he finally able to offer a price so generous it could not be refused. The Control Defendants cared little as to how much RCAP paid for Strat Cap because they shouldered only a small portion of that expense, while reaping all the benefits through AR Capital. At their direction, RCAP acquired Strat Cap for $77.5 million – $67.5 million in cash plus $10 million in RCAP Class A common stock, plus potential earn-outs.

92. Remarkably, this significant acquisition – committing RCAP to pay total compensation that could have topped $174 million – was rushed through board approval without a meeting, through written consent on the basis of a single powerpoint deck containing a single page "valuation analysis." As noted above, the independent Board members were not told what the Control Defendants already knew – that Strat Cap's historic record of positive EBITDA was the result of running wholesale distribution on arms'-length terms, bargaining for a percentage of their clients' management economics in order to earn a reasonable return. Nor was the Board told that the Control Defendants intended to require Strat Cap to distribute AR Capital products on the same abusive terms they were already imposing on Wholesale.

93. This abuse would have destroyed Strat Cap's profitability in normal circumstances. But less than two months after the Strat Cap transaction closed, the ARCP fraud disclosure – and the resulting widespread embargo on everything remotely touched by Schorsch – effectively destroyed even Strat Cap's existing business of distributing non-AR Capital products. LPL, the nation's largest independent broker-dealer and by far the most important pipeline for Strat Cap, suspended all of its selling agreements with Strat Cap, announcing that it would "accept nothing from a Schorsch entity."

94. The Strat Cap acquisition was an unmitigated disaster for RCAP. At the time of the acquisition, Strat Cap was en route to achieving $9.6 million in EBITDA for 2014, forecasted to grow to $20.6 million in 2015 and $35.7 million in 2017. Actual 2015 EBITDA was $1.56 million. As the end of that year approached, with no ability to forecast meaningful future business in light of RCAP's situation at the time, the independent directors had no choice but to cut their losses and agree to sell Strat Cap back to its former owner for $8.8 million ($5 million in cash plus a working capital adjustment) and the waiver of approximately $20 million of earn-out obligations. To summarize: In barely a year, the Control Defendants had RCAP acquire Strat Cap for $77.5 million; Strat Cap produced a little over $5 million in EBITDA (mostly in the tail months of 2014); and then it was sold back for a fraction of the purchase price.

2. SK Research

95. The acquisition (or creation) of SK Research was similarly intended only to serve the interests of the Control Defendants: to defang a critic of AR Capital products.

96. Snyder Kearney LLC was a law firm that had become the industry leader in conducting due diligence on alternative investment product offerings for broker-dealers, serving a function much like rating agencies and equity analysts do with respect to publicly traded investments. It had developed an

enviable roster of broker-dealer clients, and evaluated tens of billions of dollars' worth of products in the market, including those sponsored by AR Capital.

97. As an independent due diligence firm, Snyder Kearney LLC had been a nuisance to the Control Defendants because it had frequently identified problems in AR Capital products. With the intent to eliminate Snyder Kearney LLC as an independent watchdog, on March 10, 2014, Schorsch caused RCAP to acquire all of the firm's assets and hire all of its employees in exchange for a payment of $10,092,000 to Todd Snyder and John Kearney. This led to dissolution of the law firm and creation of an in-house RCAP research arm called SK Research.

98. Orchestrated by Schorsch, this multi-million dollar deal was negotiated in approximately three weeks. The purchase price was not based upon any financial analysis and was not supported by projections or anything remotely resembling a business plan; rather, Schorsch apparently came up with the figure as an amount that would be too high for Messrs. Snyder and Kearney to refuse. The deal was approved solely by the interested individual defendants who comprised the Executive Committee of RCAP's board of directors – defendants Schorsch, Kahane, Weil, Budko, and Block – without any presentation to the full board, let alone consideration or approval by independent directors. There was no reasonable expectation that the SK Research acquisition would add material value

for RCAP – it simply served AR Capital's interests to use RCAP's money to attempt to eliminate an independent watchdog.

99. The Control Defendants knew or should have known that SK Research would never be taken seriously by the investment community as an independent and objective source of research, in light of the glaring perception of conflict of interest that inevitably came with being owned by a Schorsch-controlled company. Many of Snyder Kearney LLC's former clients were reluctant to recommend SK Research because they viewed it as a competitor by virtue of its affiliation with RCAP's retail broker-dealer business. Non-AR Capital sponsors were reluctant to allow SK Research to conduct due diligence on their products because, even if they trusted its objectivity, they were concerned about information barriers and confidentiality obligations. Even setting aside the conflict issue, as part of a regulated broker-dealer Snyder and Kearney's team was legally prohibited from providing the legal services (and entering into the attorney-client relationships) that were an integral part of the value they had provided as a law firm.

100. The Control Defendants were well aware that the due diligence component of SK Research's business would generate significantly lower gross revenues than Snyder Kearney LLC had achieved, and they never developed a

strategy to turn it into a viable business. They nevertheless recklessly built up the unit to approximately twenty employees before its spinoff.

101. Not surprisingly, the SK Research was an economic disaster for RCAP – as defendants must have known it would be. On January 15, 2016, RCAP sold substantially all of SK Research's assets back to Messrs. Snyder and Kearney for approximately $1 million, net of adjustments. In addition to the loss of almost the entire $10+ million purchase price, RCAP lost more than $18 million operating SK Research (before impairment).

3. <u>Docupace Technologies</u>

102. RCAP's acquisition of a majority interest in Docupace Technologies ("Docupace"), a small company specializing in back-office software for broker-dealers, was another transaction that served only AR Capital's interests. Regulatory requirements make it costly and complex to approve and process orders for non-traded products, which limits the ability of small retail broker-dealers to offer such products to their advisors. AR Capital thus had an interest in developing software that could induce smaller retail broker-dealers to sell its products. But the acquisition had no business rationale for RCAP, which is not a technology company and already had adequate back-office software solutions in place.

103. Once again, the transaction was approved by conflicted fiduciaries with no safeguards for RCAP's independent interests. On September

17, 2014, RCAP's Board delegated authority to consider and approve the transaction to the Executive Committee, a subset of the Board consisting entirely of Control Defendants Schorsch, Kahane, Budko, and Weil. On November 21, 2014, these Control Defendants, with no review or approval by disinterested fiduciaries, caused RCAP to acquire a majority interest in Docupace for $35.4 million in cash and common stock, plus up to $48 million in 2015 and 2016 if certain earnings targets were met.

104. These disloyal fiduciaries understood that Docupace's projected revenue increase from approximately $4 million to $26 million between 2014 and 2016 was heavily dependent on unsupported assumptions of future growth. They did not care because they were investing public stakeholder money to create more capacity to sell AR Capital product – not to create a viable business for RCAP.

105. Because the acquisition was important to the Control Defendants, Weil directed outside counsel to nail down the terms of the acquisition without delay, ignoring several major issues identified with the transaction. Outside counsel sensed the conflicting interests in the transaction and expressed to Weil his frustration that others on the RCAP team seemed as loyal to Docupace and the acquisition as they were to RCAP.

106. It was obvious from the start that the Docupace acquisition served only AR Capital's interests. The unanimous written consent approved by

the RCAP executive committee included a requirement that Docupace enter into a product agreement with AR Capital upon execution of the acquisition's Contribution Agreement. Thus, as part of the deal, AR Capital was guaranteed access to Docupace's products and services. The Control Defendants used their insider control to reap these benefits for AR Capital while causing RCAP to bear all the costs of funding the deal. Not surprisingly, immediately after the acquisition, Weil directed Docupace to develop the product that AR Capital desired: prototype software for order processing of non-traded products – something RCAP itself did not need.

107. The lack of any strategic rationale for the Docupace transaction was acknowledged in e-mails between independent director Auerbach and RCAP's Chief Financial Officer Brian Jones shortly after the acquisition was consummated. As with SK Research, it also soon became apparent that the transaction was value destructive to Docupace itself. Docupace's customers and regulators believed that a technology firm like Docupace engaged in digital storage of customer data should operate independently of any broker-dealer or registered investment advisor, such as Cetera. These concerns led customers and potential customers to seek solutions elsewhere and hampered Docupace's growth and profitability.

108. Yet again, the Control Defendants used tens of millions of dollars of RCAP money to purchase an asset whose entire purpose was to further

the growth of AR Capital, and the drain continued as RCAP was required to pour approximately $1 million per month into the development of AR Capital's software. In the fourteen months RCAP owned a majority stake in Docupace prior to bankruptcy, the business generated only $7.5 million in gross revenues and incurred more than $5.3 million in net pre-tax losses (before impairment). After filing for bankruptcy, RCAP sold its majority stake in Docupace – which it had acquired for $34.5 million – back to Docupace's management for $9 million (together with release of certain litigation claims the new purchasers had asserted, which were vigorously contested).

E. The Control Defendants Directed Wholesale Employees to Engage in Proxy Fraud to Facilitate Their Hoped For Apollo Cash-Out

109. Throughout 2015, Schorsch's empire was still reeling from the effects of the ARCP fraud disclosure, with RCAP suffering large losses and heading towards insolvency as a result of the Control Defendants' relentless exploitation of their conflict to advance the interests of AR Capital at RCAP's expense. In April 2015, at the instigation of lead independent director Mark Auerbach, a Special Committee of independent RCAP directors was formed to explore restructuring options. The Special Committee engaged Cleary Gottlieb Steen & Hamilton LLP as counsel and Centerview Partners as financial advisor

and began soliciting third party proposals to provide a cash infusion as part of a desperately needed restructuring.

110. Meanwhile, in an attempt to cleanse the ongoing taint of the accounting fraud, the Control Defendants sought to engineer a partial buy-out of AR Capital by Apollo, the prominent private equity fund. Apollo was evidently interested in such a transaction as a way to gain entry into the REIT business. But Apollo was not interested in buying a large stake in AR Capital unless it could simultaneously acquire Wholesale, which it would need to continue to raise funds (including for its own sponsored products). Schorsch thus told the Special Committee that the Control Defendants would exercise their controlling B share to block any transaction for RCAP other than one he would negotiate with Apollo.

111. The Special Committee and its advisors nonetheless developed a promising alternative proposal from a large and well-respected private investment firm – transmitted to Weil on June 13, 2015, in the form of an offer worth between $300 and $350 million, which would have assured RCAP's continued ability to satisfy ongoing debt obligations and retained some value for existing shareholders. On June 25, 2015, Apollo transmitted their amended investment proposal of $100 million to RCAP. This Schorsch-negotiated Apollo deal was worth far less than the competing proposal and was conditioned on a "concurrent or prior closing of Apollo transaction with AR Capital."

112. The Special Committee wanted to pursue the competing proposal, but Schorsch demanded that they "put their pencils down" on anything other than his favored Apollo deal. In a July 27, 2015, e-mail, Weil asked independent director Auerbach to confirm that the due diligence data room had been closed to the competing investor "now that the special committee is pencils down." Auerbach has testified to his opinion that this interference forced RCAP to accept an Apollo deal – which was ultimately terminated – that was "substantially inferior" to what could have been negotiated with the other third party.

113. In August 2015, Apollo reached agreement with the Control Defendants on a series of transactions, which included (1) an infusion of $25 million in new capital into RCAP in exchange for preferred stock; (2) the purchase by Apollo of RCAP's wholesale business for approximately $20 million, subject to potential downward adjustment; (3) entering into an off-market strategic partnership agreement between Apollo and RCAP that would require RCAP to distribute Apollo investment products on terms equal to or better than the already-favorable treatment being accorded to AR Capital products; and (4) the purchase by Apollo of 60% of AR Capital's business for $378 million in cash and stock, subject to more than $500 million in potential upward adjustment based upon the future performance of the Apollo/AR Capital entity. The massive amount Apollo

was prepared to pay for 60% of AR Capital reflects the profitability of the stream of fees being generated by the investments raised by Wholesale.

114. For reasons that remain unclear, on November 8, 2015, Apollo and AR Capital terminated the deal to acquire a 60% stake in an entity formed to acquire AR Capital's assets, and RCAP announced a new agreement for Apollo to purchase RCAP's Wholesale business for only $6 million in cash, subject to certain purchase price adjustments. Thus, after the Control Defendants threw hundreds of millions of dollars of other peoples' money into Wholesale, reaping huge benefits for AR Capital that continued unabated, RCAP was relegated to selling Wholesale to Apollo for a pittance. But worse was still to come.

115. During the summer and fall of 2015, AR Capital was in the process of amending the charters of certain of its sponsored funds to facilitate the prospective Apollo transactions favored by Schorsch. These included changes that would increase the power of the investment fund boards and decrease the ability of shareholders to remove or make demands of board members. One AR Capital-sponsored fund called Business Development Corporation of America ("BDCA") scheduled a special meeting in September 2015 to approve a new advisory agreement, as required to facilitate the Apollo transaction.

116. These changes required shareholder approval by fund investors. To obtain those approvals, AR Capital engaged the services of a traditional proxy

solicitation firm, but did not stop there. The Control Defendants also ordered Wholesale's sales representatives to engage in feverish and often improper efforts to obtain the necessary shareholder consents. Especially as the BDCA Annual Meeting and other shareholder votes were repeatedly delayed due to lack of a quorum, the Control Defendants and their minions placed extraordinary pressure on Wholesale employees to deliver the required proxies – which were plainly for the benefit of AR Capital and Apollo, not RCAP. During the September 2015 BDCA solicitation campaign, AR Capital and Apollo purportedly paid $375,000 to RCAP for this work.

117. Wholesale employees had often in the past been called upon to help on proxy solicitation efforts, even where an independent proxy solicitation firm was also engaged. As work towards the Apollo transaction increased in the summer and fall of 2015, the high pressure proxy campaigns came to overwhelm any other business putatively being done by Wholesale, which was already massively unprofitable, and in September 2015 Wholesale even hired temporary employees to help with the increased workload. Wholesale employees later admitted to counsel and regulators that they were given no proxy solicitation training and provided with no script to use in calling investors – only intense pressure to get results.

118. On June 11, 2015, the Massachusetts Securities Division ("MSD") issued a subpoena requesting documents related to proxy solicitation efforts that had been conducted out of the Boston office. The subpoena was based on allegations made by a whistleblower employee from the Boston office who had told his supervisor of concerns about unethical behavior involving proxy solicitations by his coworkers. Rather than investigating, the supervisor told the whistleblower to "suck it up" and "be a team player." High pressure to solicit shareholder votes continued and even increased. In October 2015, in response to inquiries from the MSD, RCAP finally tasked an outside law firm to conduct an internal investigation of the proxy solicitation misconduct. That internal investigation – which cost RCAP more than $600,000 – quickly revealed an astonishingly pervasive pattern of improper conduct.

119. As RCAP's business continued to deteriorate, the prospects to close on the Apollo transaction faded, but the Control Defendants prevented RCAP from seeking any alternative to bail out Wholesale. As noted above, on November 8, 2015, AR Capital and Apollo mutually terminated the agreement to acquire the 60% stake in the joint AR Capital/Apollo partnership, and RCAP announced an agreement for Apollo to purchase RCAP's wholesale business for only $6 million in cash, subject to certain purchase price adjustments.

120. A few days later, on November 12, 2016, the MSD filed an administrative complaint to suspend Wholesale's broker-dealer license based on blatant proxy fraud by its employees in obtaining shareholder votes to allow BDCA to alter its advisory agreement. The complaint alleged that Wholesale employees, "facing intense pressure from management," "thinly-veiled threats regarding continuing employment," and even threats to "their own personal well-being," acted to "steamroll" shareholders into voting in favor of management, including at least two instances where Wholesale employees impersonated shareholders to vote their shares. In at least one case, the employee actually used a "contrived accent" to impersonate a BDCA shareholder.

121. While the MSD complaint identified only two specific instances of impersonation, RCAP's outside counsel uncovered numerous additional serious instances of misconduct during the summer and fall of 2015, all related to proxy efforts for the benefit of AR Capital. In addition to the MSD investigation, both the SEC and FINRA sent RCAP inquiry letters in November and December 2015 related to allegations of proxy fraud. If RCAP had not already been in the process of winding down Wholesale entirely to stem its ongoing losses and in response to the MSD investigation, and had RCAP not filed for bankruptcy shortly thereafter, it is likely that the SEC and FINRA would have pursued their own highly damaging investigations.

122. The proxy solicitation fraud and resulting MSD investigation were the final nails in Wholesale's coffin. After the MSD complaint was filed, even the $6 million transaction was terminated. In December 2015, RCS entered into a consent order essentially stipulating to the accuracy of all of the allegations in the complaint, paying a $3 million fine, and agreeing to permanently discontinue wholesale operations in Massachusetts.

V. CODA: THE SHORT UNHAPPY LIFE OF RCAP

123. The RCAP story reflects a remarkable course of conduct through which defendants squandered hundreds of millions of dollars – mostly of other people's money. RCAP had begun its existence as a publicly traded company with the consummation of a $50 million initial public offering in June 2013. A secondary offering the next year brought in an additional $385 million from public investors. (Through RCAP Holdings, the Control Defendants simultaneously sold five million shares of their own stock to the public and pocketed more than $100 million.) RCAP also raised more than $550 million in first lien debt, $150 million in second lien debt, more than $150 million in unsecured debt, and $277.5 million in convertible preferred stock. All told, public stakeholders pumped well over $1.5 billion in cash into RCAP – not counting amounts advanced by trade creditors. But after barely two and a half years RCAP was forced to enter bankruptcy. SK Research, Docupace, and Strat Cap were sold

back to their original owners for a fraction of what the Control Defendants had RCAP pay for them. Wholesale was shuttered completely. Only the retail broker-dealer business remained to be reorganized. Stakes in the reorganized retail broker-dealer were sufficient to satisfy the first lien claims and a small fraction of the second lien claims. Equity was completely wiped out; unsecured creditors stand to recover nothing beyond the proceeds of this and other litigation.

124. In sum, in thirty months nearly $1 billion in public stakeholder investments was destroyed. Every penny of loss was the result of wrongdoing by Schorsch and his colleagues. Through disloyal self-dealing they forced RCAP to run a money-losing Wholesale business irrationally without demanding and getting a share of ongoing management economics; they concealed the ARCP fraud, allowing RCAP to enter an acquisition agreement that directly resulted in a $60 million loss and depriving RCAP of the ability to separate itself from Schorsch to avoid the ongoing injury that resulted; they forced RCAP to engage in numerous foolish acquisitions that benefitted AR Capital at RCAP's expense; and, as the inevitable collapse ensued, they blocked RCAP's ability to save the business by negotiating a deal with a third party while fostering proxy fraud that killed off what little value remained in Wholesale.

125. Meanwhile, defendants enjoyed and indeed continue to profit from their wrongdoing. Their effort to turn RCAP into a money-raising machine

funded by public stakeholders was a resounding success: Wholesale raised more than $20 billion in investments for AR Capital, generating hundreds of millions of dollars in fees every year. Most of those funds continue to generate fees for the newly dubbed AR Global – all of which defendants keep for themselves. This lawsuit seeks to rectify this manifestly inequitable, and actionable, state of affairs.

COUNT I

Breach of Fiduciary Duty (against Defendants Holdings, Schorsch, Kahane, Weil, Budko, Block, and Quarto)

126. Plaintiff repeats and incorporates by reference each of the allegations set forth above.

127. By virtue of their controlling equity interest in RCAP, defendants Holdings and Schorsch, Kahane, Weil, and Budko owed fiduciary duties to RCAP and its shareholders and subsidiaries including, but not limited to the duties of care and loyalty.

128. By virtue of their roles as officers and/or directors of RCAP or RCS, defendants Schorsch, Kahane, Weil, Budko, Block, and Quarto owed similar fiduciary duties.

129. Defendants breached their fiduciary duties of loyalty and care through the conduct described above, including but not limited to:

- Failing to insure that decisions were made for RCAP and its subsidiaries by disinterested officers and directors without conflicting loyalties to AR Capital, Schorsch, and the other Control Defendants and failing to exercise due care and independent judgment as to the wisdom of causing RCAP and its subsidiaries to enter into business relationships and transactions;
- Requiring RCAP to run Wholesale on non-market terms that made it impossible to earn a fair and reasonable return – essentially shifting costs to RCAP and diverting corporate opportunities (including the ability to bargain for a share of Management Economics) and profits to AR Capital and its affiliates;
- Wasting corporate assets by forcing RCAP to wildly overstaff Wholesale to maintain the maximum possible volume capacity to sell AR Capital product despite the declining performance and mounting losses of RCAP's wholesale business;
- Perpetrating and concealing the massive accounting fraud at ARCP, and failing to disclose the fraud to independent members of the RCAP Board, thereby depriving RCAP of the ability to avoid or mitigate harm by severing its relationship with the Control Defendants and ending its reliance on AR Capital products;

- Causing RCAP to enter into the Cole Capital purchase agreement with ARCP without disclosing that the ARCP Audit Committee was concurrently investigating – and would ultimately uncover – the ARCP fraud;
- Causing RCAP to enter into transactions of little or no value to its business in order to further the interests of AR Capital and the Control Defendants, including, without limitation, the acquisition of Strat Cap, the creation of SK Research, and the acquisition and continued funding of Docupace;
- Using their control to prohibit the Special Committee of independent directors from pursuing a potential restructuring transaction with a counterparty other than Apollo; and
- Directly or indirectly causing Wholesale employees to engage in outlandish proxy fraud in the service of AR Capital's interests.

130. RCAP has suffered and will suffer damages as a result of the defendants' wrongful and inequitable conduct and is entitled to an award of damages.

COUNT II

Aiding and Abetting Breach of Fiduciary Duty (against Defendants Holdings, Schorsch, Kahane, Weil, Budko, Block, and Quarto)

131. Plaintiff repeats and incorporates by reference each of the allegations set forth above.

132. In the alternative to the claim set forth in Count I, to the extent any or all of defendants Schorsch, Kahane, Weil, Budko, Block, and Quarto are determined not to have owed direct fiduciary duties of care and loyalty to RCAP and/or any of its subsidiaries at any relevant time, each of these defendants knowingly participated in breaches of fiduciary duty by other defendants and thus is liable for aiding and abetting such breaches.

133. RCAP has suffered and will suffer damages as a result of the wrongful and inequitable conduct of defendants Schorsch, Kahane, Weil, Budko, Block, and Quarto and is entitled to an award of damages.

COUNT III

Unjust Enrichment and Constructive Trust (against AR Capital, AR Global, and the Advisor Defendants)

134. Plaintiff repeats and incorporates by reference each of the allegations set forth above.

135. The course of conduct described above unjustly enriched AR Capital and each of the Advisor Defendants because each received the benefits of income flowing from sales made and supported by RCAP without entering into customary arrangements to share advisory and management business with RCAP on terms consistent with an arm's-length market transactions, such as would provide the Wholesale business with reasonable returns and allow it to function as a viable ongoing business.

136. RCAP was unjustly impoverished in proportion to the degree that defendants were unjustly enriched.

137. The unjust shifting of value from RCAP to defendants was not justified, unfair, and inconsistent with ordinary commercial practice. The imbalance imposed upon RCAP would not have been negotiated in a fair, arm's-length relationship.

138. AR Capital and the Advisor Defendants had actual or constructive knowledge of the unjust enrichment flowing from the facts described above.

139. RCAP may otherwise lack an adequate remedy at law against these defendants.

PRAYER FOR RELIEF

WHEREFORE, RCS Creditor Trust respectfully requests that this Court enter an order:

A. declaring that the Control Defendants, Holdings, and Quarto have breached their fiduciary duties to RCAP and/or aided and abetted such breaches;

B. awarding plaintiff damages against the Control Defendants, Holdings, and Quarto in an amount to be proven at trial;

C. ordering the imposition of a constructive trust and the disgorgement of unjust enrichment against AR Capital, AR Global, and the Advisor Defendants;

D. directing that defendants account for all purported damages suffered as a result of the defendants' wrongdoing;

E. awarding plaintiff pre- and post-judgment interest;

F. awarding plaintiff the costs and disbursements of this action, including reasonable attorneys' fees; and

G. granting such other and further equitable relief as the Court deems just and proper.

ASHBY & GEDDES

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