IN THE COURT OF CHANCERY OF THE STATE OF DELAWARE

RCS CREDITOR TRUST, Plaintiff, v. NICHOLAS S. SCHORSCH, et al., Defendants.	C.A. No. 2017-0178-VCG

ARC PARTIES' MEMORANDUM OF LAW
<u>IN SUPPORT OF MOTION TO DISMISS</u>

PAUL, WEISS, RIFKIND, WHARTON & GARRISON LLP

Stephen P. Lamb (#2053)
Meghan M. Dougherty (#4787)
500 Delaware Avenue, Suite 200
Post Office Box 32
Wilmington, Delaware 19899-0032
Telephone: (302) 655-4410

Attorneys for Defendants Nicholas S. Schorsch; Edward M. Weil, Jr.; William Kahane; Peter M. Budko; 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

OF COUNSEL:

Allan J. Arffa
Gregory F. Laufer
Jeremy A. Benjamin
PAUL, WEISS, RIFKIND, WHARTON & GARRISON LLP
1285 Avenue of the Americas
New York, New York 10019-6064
Telephone: (212) 373-3000
Facsimile: (212) 757-3990

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The ARC Parties[1] respectfully submit this memorandum of law in support of their Motion to Dismiss the complaint in this action (the "Complaint").

PRELIMINARY STATEMENT

Plaintiff RCS Creditor Trust (the "Trust")—a follow-on entity formed purportedly to benefit unsecured creditors as part of the Chapter 11 bankruptcy case of RCS Capital Corporation ("RCAP") and its subsidiaries—has filed a "kitchen sink" pleading that, despite its bluster, merely confirms what two independent internal investigations at RCAP revealed, and RCAP's independent board chairman has testified: none of the ARC Parties engaged in any wrongful conduct with respect to RCAP.

The Trust asks the Court to imagine a grand conspiracy among all eighteen defendants that the Trust claims infected seemingly every business decision RCAP ever made. Even more implausibly, the Trust asks the Court to believe that—although many of the defendants held significant financial interests

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[1] The ARC Parties consist of defendants Nicholas S. Schorsch; Edward M. Weil, Jr.; William Kahane; Peter M. Budko and Louisa Quarto (collectively, the "Individual ARC Defendants"); RCAP Holdings LLC ("Holdings"); AR Capital, LLC ("AR Capital"); AR Global Investments, LLC ("AR Global"); and 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 (collectively, the "Advisor Defendants"). The ARC Parties thus include all defendants other than Brian S. Block.

in RCAP, and although numerous bankers and investors repeatedly scrutinized RCAP's business in great detail—defendants created RCAP to be unprofitable from its inception, and thereafter forced RCAP to engage in a series of unprofitable activities, chiefly acquisitions. The purpose of the plot, according to the Complaint, was to reduce costs at AR Capital, a private company in which some (but not all) of the defendants held an equity stake.

The Complaint asserts three claims: breach of fiduciary duty against the Individual ARC Defendants and Holdings (Count I); aiding and abetting breach of fiduciary duty against those same defendants (Count II); and unjust enrichment/constructive trust against AR Capital, AR Global and the Advisor Defendants (Count III). But the Trust's allegations do not support these claims.

The various allegations the Trust makes in Count I, for purported breach of fiduciary duty, largely fall into four categories: (1) complaints about the business model employed by one RCAP subsidiary, Realty Capital Securities, LLC ("RCS"); (2) complaints that RCS hired too many employees; (3) complaints about transactions that RCAP pursued with unrelated third parties; and (4) complaints about misconduct by RCS's employees. As detailed below, the Trust's claims are not remotely plausible. Indeed, the "supporting" allegations (when they exist) are at odds with black letter law, internally inconsistent, and otherwise completely implausible. Those allegations are insufficient to withstand a motion to dismiss. As to the four categories:

First, the Trust alleges that the Individual ARC Defendants (who were directors of RCAP, officers of RCAP or officers of its subsidiaries at various times) and Holdings (the holder of a majority voting interest in RCAP) somehow violated fiduciary duties supposedly owed to RCAP by allegedly creating for, and imposing on, RCAP a business model that was known to be unprofitable. Ignoring all of RCAP's other significant activities, the Trust focuses exclusively on one RCAP subsidiary, RCS—a wholesale broker of various investment vehicles, including real estate investment trusts (or "REITs")— many of which AR Capital sponsored. The Trust claims that RCS's business model was "inherently unprofitable" and the defendants who conceived and imposed that business model thereby breached fiduciary duties owed to RCAP.

The critical defect of this claim derives from the fact that RCS was created in 2007 as a wholly owned subsidiary of Holdings,[2] and RCS's business remained unchanged even after Holdings took RCAP public (with RCS becoming a subsidiary of RCAP) in mid-2013. Under settled Delaware law, no breach of fiduciary duty claim can exist in such a situation, because no defendant owed a fiduciary duty to RCAP or its *future* stockholders when RCS adopted and

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[2] At the time, Holdings was known as American Realty Capital II, LLC.

implemented its business model. *See Anadarko Petroleum Corp.* v. *Panhandle E. Corp.*, 545 A.2d 1171 (Del. 1988).

As if that were not enough, the alternative business model that the Trust insists RCS should have implemented would have been *illegal* under governing regulations. In particular, the Trust claims that RCS should have received management fees for the non-traded REITs whose securities RCS distributed. As the Trust concedes, however, RCS never performed any such management services. Further, the governing rules promulgated by the Financial Industry Regulatory Authority, or "FINRA," explicitly *prohibited* RCS from collecting such fees. *See* FINRA, Rule 2310 (2016) ("Rule 2310"); FINRA, Rule 5110 (2016) ("Rule 5110").

Second, the Trust complains about hiring practices at RCS while RCS was a subsidiary of the publicly held RCAP. Specifically, the Trust maintains that the Individual ARC Defendants and Holdings violated supposed duties to RCAP by causing RCS to hire too many people. Leaving aside whether business decisions at RCS can be attributed to all of the Individual ARC Defendants (who had a variety of relationships with RCAP) or Holdings (which held a majority of the voting rights of the common equity of RCAP), such decisions do not state a claim for breach of fiduciary duty. Rather, they are routine business decisions deserving the protections of the business judgment rule. The Trust's claim is merely a disguised corporate waste claim that comes nowhere near meeting the applicable pleading requirements because, as the Trust admits, “more salespeople spending more money *produced more sales* . . . .” (Compl. ¶ 67 (emphasis added).)

Third, the Trust also challenges a series of transactions—with entities called Strat Cap, SK Research, and Docupace Technologies—entered into by RCAP. According to the Trust, RCAP’s efforts to acquire these companies (which concededly were not affiliated with any defendant) were motivated by the Individual ARC Defendants’ and Holdings’ desire to benefit AR Capital, not RCAP. But these conclusory allegations of motive fail to overcome the business judgment presumption that RCAP’s directors acted in good faith in considering these transactions.

Fourth, the Trust asserts that misconduct by RCS’s employees in connection with a proxy solicitation was a breach of fiduciary duty by the Individual ARC Defendants and Holdings. The regulators who investigated the incident, however, determined that only RCS, not any ARC Party, committed the wrongdoing. Not surprisingly then, the Trust offers no allegations of any wrongful conduct by any defendant to support this claim.

The Trust’s other claims fare no better. Count II, for aiding and abetting breach of fiduciary duty, fails first because there was no underlying breach of fiduciary duty, and also because the Trust fails to allege knowing participation, a necessary element of such a claim.

Count III alleges that the Advisor Defendants, AR Capital, and AR Global were somehow unjustly enriched by receiving management fees for work that they performed, while RCAP was somehow unjustly impoverished by not receiving such compensation for services it never performed and was, by rule, not entitled to receive. This nonsensical claim both (a) ignores the express contracts between the Advisor Defendants and RCS, and (b) effectively seeks unearned and impermissible compensation.

Finally, under any circumstance, the Complaint makes no allegations of actual wrongdoing as to two defendants—Louisa Quarto and Holdings—and thus they should be dismissed.

Remarkably, in all of its complaints about the management of RCAP, the Trust fails to mention RCS Capital Management, LLC ("RCS Management"), *the entity that actually managed RCAP* for a substantial fee during the relevant period. The reason for this omission is highly revealing.

Luxor Capital Partners and related entities—an investment firm that had invested in RCAP since 2014, and sometimes held as much as 8% of its equity—has been and remains a member of RCS Management. If the Trust were correct that RCAP was grossly mismanaged, RCS Management would be the logical litigation target. But, it so happens that the Trust is dominated by Luxor, and Luxor's lawyers in RCAP's bankruptcy case and elsewhere now represent the Trust in this litigation. The internal contradictions of the Complaint, and its inherent illogic, are the direct result of the Trust's lawyers' desire to concoct a purported claim on behalf of RCAP against the ARC Parties that does not also accuse Luxor of misconduct, even though it was deeply entrenched in the management and business strategies of RCAP.

Regardless of this omission, the Trust's allegations fail to state a claim.

STATEMENT OF FACTS[3]

A. AR Capital

In 2007, Nicholas S. Schorsch and William Kahane founded American Realty Capital, LLC, a privately held company that, with its subsidiaries, created and managed private and public non-traded investment vehicles, largely non-publicly-traded REITs. (Compl. ¶¶ 24, 28.) Mr. Schorsch and Mr. Kahane, along with Edward M. Weil, Jr., Peter M. Budko, and Brian S. Block, built American Realty Capital into the largest creator and sponsor of such REITs in the United States. (*Id.*)

[3] The allegations contained in the Trust's complaint are assumed to be true solely for purposes of this motion. *See Malpiede* v. *Townson*, 780 A.2d 1075, 1082 (Del. 2001).

B. The REIT Industry

A REIT is an investment vehicle that owns and typically manages income-producing real estate or real estate-related assets. (*Id.* ¶¶ 24, 44.) To qualify as a REIT, and obtain certain tax advantages, the investment vehicle must transfer at least 90 percent of its annual taxable income to its investors. (*Id.* ¶ 24.) REITs thus allow investors to earn a share of the income (for example, rental fees) from real estate properties in a tax-efficient manner. (*Id.* ¶¶ 24, 44.)

REITs may be publicly traded (*i.e.*, registered with the SEC and listed on a stock exchange); public and non-traded (*i.e.*, registered with the SEC but not listed on any exchange and typically marketed and sold by a "broker-dealer" or "dealer manager"); or private (*i.e.*, not SEC-registered and sold directly via private placement). American Realty Capital's business focused on public non-traded REITs. (*Id.* ¶¶ 2, 29.) Public non-traded REITs are highly regulated, including by FINRA (*id.* ¶¶ 4–5, 46), the SEC, and various State regulatory bodies.

Two stages of a public non-traded REIT's life-span are relevant here: (1) the offering phase, involving a capital raise from investors to purchase one or more real estate assets; and (2) the operations phase, involving the day-to-day management of the REIT's holdings until the REIT is liquidated or listed on an exchange. (*See id.* ¶ 44.)

1. Stage One: REIT Offerings and the Creation of RCS

A non-traded REIT is formed when a sponsor (such as American Realty Capital) identifies a suitable investment opportunity, such as a particular real estate sector, property or type of property, and creates an investment vehicle designed to capitalize on that opportunity. (*Id.* ¶¶ 24, 44.)

To obtain investors, the REIT sponsor retains a FINRA-registered wholesale broker-dealer responsible for distributing the REIT's securities to investors. (*Id.* ¶¶ 45-46.) The wholesale broker-dealer forms a selling group of retail broker-dealers that, through their financial advisors, sell the REIT's securities to their clients, generally individual retail investors. (*Id.*)

In 2007, to facilitate the distribution of its REIT securities, American Realty Capital created a subsidiary, RCS, a FINRA-registered wholesale broker-dealer. (*Id.* ¶ 29.) RCS distributed (among other things) REIT securities through selling groups comprised of FINRA member retail broker-dealers that had agreed to carry American Realty Capital products. (*Id.* ¶ 45.) Financial advisors registered with those retail broker-dealers sold the securities to their clients who in turn became investors in one or more American Realty Capital REITs. (*Id.*)

In connection with its distribution of the REIT securities, RCS received underwriting compensation in the form of selling commissions and dealer manager fees. RCS paid the participating retail broker-dealer the entirety of the selling commissions and a portion of the dealer manager fee—the "dealer manager fee reallowance"—that RCS received on each sale. (*Id.* ¶¶ 46-47.) The retail broker-dealer would then determine what amount of the selling commission it would pay to its financial advisors, and would retain the dealer manager fee reallowance. (*Id.*) RCS would retain the remainder of the dealer manager fee.

Much of the Complaint consists of an attack on RCS's business with respect to the compensation it earned in connection with its distribution of American Realty Capital (and later AR Capital) sponsored REIT securities—specifically the fact that RCS, as a wholesale distributor of such securities, retained as compensation only 1-2% of the funds it raised, an amount allegedly "not enough to generate a reasonable profit as a freestanding business." (*Id.* ¶ 5.) That fee structure, however, is not only traditional in the industry, *it is mandated by FINRA rules*.

FINRA directly regulates the amounts that broker-dealers can charge as compensation in connection with offerings of REIT securities. (*Id.* ¶¶ 5, 46.) Specifically, FINRA rules cap the underwriting compensation that a wholesale broker-dealer may earn (including what it might share with retail broker-dealers) in connection with sales of public non-traded REITs to 10% of the total capital raised. (*Id.*); *see* FINRA Rule 2310.

As the Trust concedes, the wholesale broker-dealer generally directs 7% of the capital raised as selling commissions to the retail broker-dealer who sells the REIT securities to its clients. (Compl. ¶ 46.) Of the remaining 3%, which is in the form of a dealer manager fee, 1-2% of underwriting compensation is typically allocated to the retail broker-dealer in the form of a dealer manager fee reallowance, and the wholesaler retains the remaining 1-2%. (*Id.*)

The compensation terms between the wholesale broker-dealer and the REIT are typically set forth in contracts referred to as Dealer-Manager Agreements or DMAs. (*Id.* ¶ 54.) There was a DMA between each American Realty Capital-sponsored REIT and RCS, as distributor of the REIT's securities. (*See, e.g.*, Arffa Aff. Ex. 1 (BDCA DMA); Arffa Aff. Ex. 2 (AR Capital – Retail Centers of America, Inc. DMA).)[4] The DMAs between RCS and American Realty Capital-sponsored REITs (as well as the REITs' investment advisors) provided that RCS received compensation within the limits set by FINRA—7% as selling commissions which RCS paid in full to the retail broker-dealer that sold the

[4] On a motion to dismiss, a court may consider materials outside the pleadings "(i) where an extrinsic document is integral to a plaintiff's claim and is incorporated into the complaint by reference, and (ii) where the document is not being relied upon to prove the truth of its contents." *Furman* v. *Del. Dep't of Transp.*, 30 A.3d 771, 774 (Del. 2011). Here, the DMAs are integral to the Trust's claims and are expressly referenced in the Complaint. (*See, e.g.*, Compl. ¶ 54.) As relevant to this motion, the DMAs are all substantially similar.

REIT's securities (which, in turn, allocated that commission to the financial advisor who sold the REIT to his or her client), 1-2% as a portion of the dealer manager fees which RCS allocated to the same retail broker-dealer, and 1-2% as the dealer manager fees which RCS retained for itself as wholesale broker-dealer. (*See, e.g.*, Arffa Aff. Ex. 1 ¶ 3(d); Arffa Aff. Ex. 2 ¶ 3(d).)

All of this is strictly in compliance with FINRA regulations. The Complaint's fundamental premise—that such commissions are "inherently unprofitable"—would come as quite a surprise to FINRA, or others in the industry. Indeed, many industry observers complain that the current compensation structure is *excessive*:

> The dealer-manager is often paid *excessive commissions* for selling shares, *as high as 10% of the share price*. These rates are substantially higher than on mutual funds and ETFs, which have commission levels of typically 2-3%. These *extraordinarily high fees* incentivize dealer-managers to sell as many shares as possible, regardless of the suitability of the investment for an individual's financial objectives. This could lead to the targeting of unsophisticated investors in particular.

A Primer on Non-Traded REITs and other Alternative Real Estate Investments, Sec. Litig. & Consulting Grp. 11 (2012), http://slcg.com/pdf/workingpapers/Non%20Traded%20REITs%20White%20Paper.pdf (emphasis added).

In fact (as discussed further below), the Trust's suggestion that RCS should have simply grabbed in addition a percentage of the advisory or management fees of the REIT is specifically barred under FINRA Rule 2310. (*See infra* at 28-32.)

The Trust's criticism also makes little sense because RCS's compensation is set as a percentage of each individual investment made: if a wholesaler sold billions of dollars of such investments (certainly the hope here), it would surely make money.

2. Stage Two: Operation of REIT Properties

Once a REIT raises sufficient investment capital, it purchases and manages one or more properties. (Compl. ¶ 44.) To fulfill these functions, which include "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," REITs typically enlist "advisors," generally affiliates of the REIT sponsor. (*Id.*) The upfront and ongoing acquisitions, asset management, and property management fees generated for the REIT from the properties acquired with proceeds raised from investors are paid to the REIT advisor for services performed under its advisory contract. (*Id.*)

That is precisely how American Realty Capital-sponsored (and AR Capital sponsored) REITs operated. For those products, the REIT retained American Realty Capital-affiliated (or AR Capital-affiliated) managers to assist with the operation and management under advisory contracts and related agreements. (*Id.*)[5] The Advisor Defendants named in the Complaint are among the advisors to American Realty Capital-sponsored (or AR Capital sponsored) REITs. (*Id.* ¶ 25.)

C. Additional Business Opportunities for RCS

In 2010, while still part of American Realty Capital, RCS began distributing non-American Realty Capital products as well. (*Id.* ¶ 50.) Around that time, Phillips Edison & Company, a real estate investor with expertise in grocery store-anchored shopping centers, and American Realty Capital determined to co-sponsor Phillips Edison Grocery Center REIT I ("PECO"), a vehicle that would own grocery-related real estate properties, and to use RCS to handle the wholesale distribution of securities issued by that REIT. (*Id.*) As part of the proposed transaction, an American Realty Capital affiliate would serve as the advisor and co-sponsor to the REIT and provide services primarily related to the management of the REIT portfolio; a Phillips Edison-owned entity would serve as the other co-sponsor and sub-advisor, to take advantage of Phillips Edison's specific grocery-business expertise. (*Id.*)

The arrangement with Phillips Edison expanded the marketplace for RCS beyond American Realty Capital products, revealing a strategy that could increase RCS's distribution volume and, in consequence, its profitability.

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[5] The advisory agreements, like the DMAs, are integral to the complaint and thus may be considered on this motion. (*See, e.g.*, Compl. ¶ 25.)

D. RCAP's Initial Public Offering, Board of Directors and Public Disclosures

By December 2012, Holdings determined to spin off its subsidiary RCAP as a standalone public company, with three wholly owned subsidiaries: (1) RCS, including its REIT wholesale distribution business, as well as its other investment banking and capital markets businesses; (2) a registered transfer agent business; and (3) a transaction management services business. (*Id.* ¶ 31.) RCS would thus become a subsidiary of RCAP capable of distributing both American Realty Capital and other products to a wide market.[6]

At approximately the same time, American Realty Capital created defendant AR Capital, which it then spun off as a stand-alone privately held

[6] RCAP's diversified businesses thus included not just RCS's REIT wholesale distribution business—which is the near singular focus of the Trust's claims. RCS itself distributed other investment vehicles, including private placements and "business designated companies." (*See* Arffa Aff. Ex. 3, at F-14) And, RCAP initially and over time operated other businesses as well. (*See id.*, at 2, 8.) Indeed, through acquisitions that the Trust complains of (discussed further below), RCAP was able to drive down costs associated with operating these various business and create synergies to further increase profitability. (*See id.*, at F-15 ("During the year ended December 31, 2014, the Company completed the acquisitions of Cetera, Summit, J.P. Turner, Hatteras, First Allied, ICH, StratCap, Trupoly and Docupace. The recent acquisitions were made in order for the Company to diversify its revenue stream and product offerings. The resulting goodwill associated with the recent acquisitions is made up of synergies related to higher strategic partner revenues as well as expense synergies associated with back office management, technology efficiencies, savings from the renegotiation of the Company's clearing contracts, the elimination of duplicative public company expenses and other factors.").)

company to which American Realty Capital contributed its REIT-sponsorship and REIT advisory and management services business.[7]

On June 10, 2013, RCAP conducted an initial public offering. (Compl. ¶ 15.) In connection with the IPO, Holdings contributed shares in each of RCAP's three subsidiaries in exchange for new shares in RCAP. Holdings retained a significant economic stake in RCAP. (*Id.* ¶ 37.)

Holdings held both Class A and Class B shares in RCAP. (*See* Arffa Aff. Ex. 4, at 12; Arffa. Aff. Ex. 3, at F-12.) While the amounts changed over time, the undisputed facts are that Holdings (a) always held a substantial (approximately 25%) economic equity interest (Compl. ¶ 37), and (b) always held a majority of voting interests, ultimately via its ownership of a single B-Class share that held 50% plus one share of the voting interests (*Id.* ¶ 16).

The Individual ARC Defendants (other than Louisa Quarto) held, and, following RCAP's IPO, continued to hold direct interests in Holdings. (*Id.* ¶¶ 17-21.) They thus retained a significant financial stake in RCAP's success.

Throughout the period from its creation until RCAP's IPO, RCS provided wholesale distribution services for American Realty Capital and AR Capital REIT products on the terms previously described—that is, a 10% total

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7 *See* Del. Dep't of State: Div. of Corps., File No. 5266721, *available at* https://icis.corp.delaware.gov/Ecorp/EntitySearch/NameSearch.aspx.

compensation on funds raised, with 7% commissions being distributed to the broker-dealer selling group member and ultimately to the financial advisor who sold the security to his or her client (who became the investor in the REIT); a 1-2% "dealer manager fee reallowance" to that same retail broker-dealer; and the remaining 1-2% dealer management fee being retained by RCS. Those terms, fully disclosed to RCAP's shareholders, remained constant following RCAP's public offering.

Indeed, both at and after the initial public offering, RCAP was obligated to, and did, make fulsome public disclosures concerning its business and finances. RCS's business model and its relationship with AR Capital and the other ARC Parties were detailed in the prospectus for RCAP's public offering. The prospectus disclosed, for example, that Holdings would "control 97.5% of the voting power of [RCAP's] outstanding capital stock" (later reduced to 50% plus one share), and would "have the ability to control the outcome of matters submitted to [RCAP's] stockholders for approval for the foreseeable future." (*See* Arffa Aff. Ex. 4, at 13.)[8] RCAP also publicly disclosed that Holdings was

[8] On a motion to dismiss, a court may take judicial notice of matters in SEC filings. *See In re Gen. Motors (Hughes) S'holder Litig.*, 897 A.2d 162, 170 (Del. 2006); *Wal-Mart Stores, Inc.* v. *AIG Life Ins. Co.*, 860 A.2d 312, 320 n.28 (Del. 2004).

"directly or indirectly controlled by" Mr. Schorsch and Mr. Kahane. (*Id.*, at 1; *see also* Compl. ¶ 39.)

Certain of the Individual ARC Defendants served as directors, and at various times as officers, of RCAP. (Compl. ¶¶ 17-20.) Ms. Quarto served only as an officer at RCAP's subsidiary RCS. (*Id.* ¶ 23.)

Although the Complaint suggests utter indifference to conflict of interest or independence issues, the truth is otherwise. The board of RCAP had independent (that is, non-AR Capital or related) directors (*id.* ¶ 54), including its Chairman, Mark Auerbach (Arffa Aff. Ex. 3, at 76), though, as the prospectus explained, RCAP was "not required to have a majority of [its] board of directors be independent." (*See* Arffa Aff. Ex. 4, at 13.)

RCS's business model, including its fee structure, was also the subject of robust disclosure. The prospectus stated, in relevant part:

> The Company receives selling commissions and dealer manager fees from affiliated and non-affiliated sponsors for its wholesale distribution efforts . . . . *The Company generally receives commissions of up to 7.0% of gross offering proceeds for funds raised through the participating independent broker-dealer channel, all of which are redistributed as third-party commissions, in accordance with industry practices*. Commission percentages are generally established in the issuers' offering documents leaving the Company no discretion as to the payment of third-party commissions . . . .
>
> The Company, serving as a dealer manager, receives fees and compensation in connection with the wholesale distribution of non-traded securities. The Company contracts directly with independent broker-dealers and investment advisors to solicit share

> subscriptions . . . . *The Company generally receives up to 3.0% of the gross proceeds from the sale of common stock as a dealer manager fee and also receives fees from the sale of common stock through registered investment advisors.* The Company has sole discretion as to reallowance of dealer manager fees to participating broker-dealers . . . .

(Arffa Aff. Ex. 4, at F-12 (emphasis added).)

Dealer manager agreements between RCS and each then-existing REIT were also publicly filed with the SEC before the initial public offering. These agreements specified the terms set forth above and in the FINRA rules: RCS could not collect more than 10% compensation on each sale; of which 7% was passed through as commissions to the retail broker-dealer, and 1-2% was paid to the selling group members as a dealer management fee reallowance. (*See, e.g.*, Arffa Aff. Ex. 1 ¶ 3(d); Arffa Aff. Ex. 2 ¶ 3(d).)

Finally, we note that the RCAP charter exculpates directors from breach of fiduciary duty claims to the full extent of Delaware law:

> "No director of the Corporation will have any personal liability to the Corporation or its stockholders for monetary damages for any breach of fiduciary duty as a director, except to the extent such exemption from liability or limitation thereof is not permitted under Delaware Law . . . ."

(Arffa Aff. Ex. 5 § 8.01.)

E. RCAP's Subsequent History After the Public Offering

After the RCAP public offering, RCS conducted business much as it had before. Although the Complaint portrays RCAP's business model as "inherently unprofitable," in fact RCS successfully performed as a wholesale broker for AR Capital-related and other REITs, and other products. RCAP's other businesses also continued operating, and RCAP purchased new businesses, including other wholesale and retail broker dealers. (*See*, *e.g.*, Compl. ¶¶ 34-35, 90.)

In fact, the major change in RCAP's business, after it went public (alluded to only briefly and indirectly in the Complaint), involved expanding into the retail brokerage business. As the Complaint recites, RCAP bought a large retail broker-dealer, Cetera, which made RCAP's business even less dependent on its RCS subsidiary. RCAP acquired other retail brokerage businesses as well. (*Id.* ¶¶ 34-35.) Although the Trust now challenges the wisdom of some RCAP acquisitions, it does not complain about the acquisition of Cetera or of any other retail brokers.

F. RCS's Bankruptcy and the Creation of the Creditor Trust

On January 31, 2016—some three and a half years after the public offering—RCAP, RCS and ten affiliated entities (the "Debtors") filed voluntary petitions for relief under Chapter 11 of the Bankruptcy Code in the United States Bankruptcy Court for the District of Delaware. *In re RCS Capital Corp. et al.*, Case No. 16-10223 (Bankr. D. Del. 2016).

Certain events during the bankruptcy cases are worth noting here. After the Debtors proposed the creation of a creditor trust as part of its Chapter 11 plan (the plaintiff Trust in this action), the Debtors asserted publicly that they might have unspecified claims against some or all of the defendants. (*See* Arffa Aff. Ex. 6, at 63 ¶ 31.)[9] As a result, a number of ARC Parties sought discovery as to the existence of any such claims. Not only did the Debtors fail to articulate the basis for any such claims, but RCAP's independent chairman, Mark Auerbach, testified at his deposition that (a) two independent investigations into the "related party transactions" involving RCAP and AR Capital-related entities had found nothing inappropriate, and (b) he was personally unaware of any evidence supporting a breach of fiduciary duty on the part of any of the ARC Parties.

It also became clear that the moving force behind the creation of the Trust was Luxor, the Debtors' single largest unsecured creditor. Not only was Luxor, a significant pre-petition investor in RCAP, it had played a substantial role in managing RCAP, through both RCS Management, and through the direct participation of its principal, Michael Conboy, *as a RCAP board member*. (*See* Arffa Aff. Ex. 6, at 25.)

[9] On a motion to dismiss, a court may take judicial notice of court filings, including filings made in other courts. *See In re Ebix Stockholder Litig.*, 2016 WL 208402, at *10 (Del. Ch. Jan. 15, 2016); *Metro. Life Ins. Co.* v. *Tremont Grp. Holdings, Inc.*, 2012 WL 6632681, at *12 (Del. Ch. Dec. 20, 2012).

In May 2016, the Bankruptcy Court confirmed the Debtors' joint plan of reorganization, including the creation of the Trust. (Compl. ¶ 14.) As part of the Plan, the Debtors transferred substantially all causes of action that they might possess to the Trust. (Arffa Aff. Ex. 7 §§ 4.3, 5.17.) A Trust Administrator, which has three trustees as overseers, one of whom Luxor appointed, administers the Trust. (*Id*. § 5.17.) As the largest unsecured creditor, Luxor is also the principal beneficiary of Trust litigation recoveries.

G. This Litigation

Approximately ten months after its creation, the Trust filed this action. Kramer Levin Naftalis & Frankel LLP, the same firm that represented Luxor in the bankruptcy cases (and has represented Luxor in numerous other matters), represents the Trust.

The Trust's Complaint names various individuals and entities associated with AR Capital:

- Mr. Schorsch, Mr. Kahane, Mr. Budko, Mr. Weil, and Mr. Block (collectively referred to in the Complaint as the "Control Defendants"), who served as directors (and, in some cases, officers) of RCAP;
- Ms. Quarto, who served as an officer of RCS;
- Holdings;
- AR Capital and AR Global; and
- the Advisor Defendants.

Over its 75 pages, the Complaint tells a fantastical tale of a grand conspiracy, apparently orchestrated by all eighteen of the defendants. The theory of the case—summed up in a so-called "coda" about the "short unhappy life of RCAP" (Compl. ¶ 68)—is that, to avoid the costs of wholesale distribution of its REIT products, some combination of the defendants spun off RCAP, in which they retained a substantial economic interest, knowing its subsidiary RCS had a flawed and unprofitable fee structure, and then caused RCAP to engage in a series of transactions intended to lose yet more money. (*Id.* ¶¶ 123-25.)

Based on these allegations, the Trust has asserted three claims. Count I asserts a breach of fiduciary duty claim against the Individual ARC Defendants and Holdings. Count II asserts an aiding and abetting breach of fiduciary duty claim against the same defendants.[10] Count III tags on a claim for unjust enrichment and seeks the imposition of a constructive trust against AR Capital, AR Global and the Advisor Defendants.

ARGUMENT

Under Delaware law, a complaint shall be dismissed if "the plaintiff could not recover under any reasonably conceivable set of circumstances susceptible of proof." *Touch of Italy Salumeria & Pasticceria, LLC* v. *Bascio*, 2014 WL 108895, at *3 (Del. Ch. Jan. 13, 2014) (citation & internal quotations

[10] Counts I and II assert liability against Mr. Block as well.

omitted). In ruling on a motion to dismiss, the court must weigh reasonable inferences in the plaintiff's favor, but "neither inferences nor conclusions of fact unsupported by allegations of specific facts . . . are accepted as true." *H-M Wexford LLC* v. *Encorp, Inc.*, 832 A.2d 129, 139 (Del. Ch. 2003) (citation & internal quotations omitted). Thus, a court "need not blindly accept as true all allegations, nor must it draw all inferences from them in [the plaintiff's] favor unless they are reasonable inferences." *Id.* (citation & internal quotations omitted). To survive a motion to dismiss, a plaintiff must plead "enough facts to suggest plausible, ultimate entitlement to the relief sought." *In re Atlas Energy Res., LLC*, 2010 WL 4273122, at *6 (Del. Ch. Oct. 28, 2010) (citation omitted).

Each of the Trust's three claims fails under these standards.

I. THE TRUST'S CLAIM FOR BREACH OF FIDUCIARY DUTY (COUNT I) SHOULD BE DISMISSED

Count I purports to assert a claim for breach of fiduciary duty against the Individual ARC Defendants and Holdings, as well as Mr. Block. That claim comprises four categories of allegations. First, the Trust alleges that those defendants violated fiduciary duties owed to RCAP because its subsidiary RCS's business model and, in particular, RCS's fee structure in its wholesale REIT distribution business, was preordained to be unprofitable. Second, these defendants supposedly breached their fiduciary duties to RCAP because they caused RCS to hire too many employees. Third, the Trust identifies certain RCAP transactions (generally with parties unaffiliated with the defendants) that it blames on the defendants, maintaining that each constituted a discrete breach of fiduciary duty. Fourth, the Trust claims that misconduct concededly committed solely by RCS employees somehow constitutes a breach of fiduciary duty by the defendants. None of these categories of allegations can survive Rule 12(b)(6) scrutiny.

A. The Breach of Fiduciary Duty Claim Fails Because It Is Based on Lawfully Required, Fully Transparent Conduct Pre-Dating the Defendants' Assumption of Any Fiduciary Duties As to RCAP

The Trust claims that the Individual ARC Defendants and Holdings breached their fiduciary duties to RCAP by imposing an allegedly unprofitable business structure on its subsidiary RCS, one that limited RCS's compensation to a percentage of the capital raised in a REIT offering—even though that is precisely how RCS conducted business before its initial public offering (Compl. ¶¶ 6, 45–46), what other REIT wholesalers do, and what FINRA regulations require. According to the Trust, the defendants should have caused RCAP's subsidiary RCS to demand and receive *management fees* with respect to the REITs (or at least the AR Capital-sponsored REITs) that RCS distributed.

This breach of fiduciary duty claim fails for three independent reasons. First, the decision that RCS would operate in this fashion arose before the Individual ARC Defendants and Holdings owed RCAP any fiduciary obligations.

Second, FINRA regulations mandate adoption of the business model that the Individual ARC Defendants and Holdings allegedly foisted on RCS; indeed, those same rules prohibit the Trust's proposed alternative business model. Third, the Trust's underlying premise—that no independent party would accept the terms on which RCS operated—is fully contradicted by the explicit disclosure of those terms to investors (including Luxor, the Trust's main proponent, de facto administrator and beneficiary), as well as by the Individual ARC Defendants' and Holdings' retention of a significant stake in RCAP.

1. Prior to RCAP's IPO, Defendants Owed No Fiduciary Obligations to RCAP

The Trust's breach of fiduciary duty claim should fail because it rests on conduct predating RCAP's initial public offering. Under longstanding Delaware law, the Individual ARC Defendants and Holdings owed no fiduciary duties to RCAP or its prospective stakeholders before RCAP became a separate, public entity. *Anadarko*, 545 A.2d at 1172, 1177 (parent company owes no fiduciary duties to prospective shareholders of subsidiary prior to spinoff).[11] Accordingly, the Trust's breach of fiduciary duty claim should be dismissed

[11] *See also Trenwick Am. Litig. Tr.* v. *Ernst & Young, L.L.P.*, 906 A.2d 168, 191 (Del. Ch. 2006) (suit by wholly owned subsidiary against parent company "is at odds with . . . settled principles of Delaware law"), *aff'd*, 931 A.2d 438 (Del. 2007) (TABLE).

because it depends on alleged acts and omissions that occurred before RCAP's IPO.

The Trust's claim is that RCS's business model (at least as to its distribution of REIT securities) was "inherently unprofitable." (Compl. ¶ 43.) That business model was conceived and implemented before the IPO. (*See id.* ¶ 6.) Similarly, the Trust alleges that "[e]ach instance in which the Control Defendants caused RCAP to assume (*when the public company was first formed*) . . . the[] off-market and ultimately disastrous agreements represented a distinct breach of their fiduciary duties." (*Id*. ¶ 57 (emphasis added).) (It is clear from the context that the "agreements" being referenced were RCS's contracts with AR Capital-sponsored REITs.) The decision to enter into those agreements occurred *before* RCAP went public. So too did the decision to take RCAP public. None of this conduct can constitute a breach of fiduciary duty, because all of it occurred *before* the assumption of any fiduciary duties. *Anadarko*, 545 A.2d at 1172, 1177.

Because the Trust's allegations concerning RCS's business model relate to conduct that predates the public offering of RCAP, they also predate the moment at which the Individual ARC Defendants and Holdings assumed any fiduciary duties to RCAP. *Id.* As a result, those allegations cannot support a claim for breach of fiduciary duty under Delaware law.

2. RCS's Supposedly Unprofitable Business Model Cannot Constitute a Breach of Fiduciary Duty Because It Was Mandated By FINRA Regulations

In addition, the Trust's allegation that the Individual ARC Defendants and Holdings created a supposedly unprofitable business model for RCAP by imposing "non-market terms" on RCS cannot be the basis of a fiduciary claim because that model was mandated by law. Indeed, what the Trust argues RCS should have done would have violated FINRA regulations.

FINRA regulates the REIT industry in which AR Capital operates and imposes strict limits on underwriting compensation paid in connection with distributing REIT securities. (*See* Compl. ¶ 5.) Specifically, Rules 2310 and 5110, which govern various types of direct participation programs including REITs, limit the compensation of FINRA members with respect to organizational and offering expenses and underwriting compensation in connection with a REIT offering. *See* Rule 2310(a)(12), (b)(4); Rule 5110(c)(3). In particular, Rule 2310 prohibits any FINRA member, which would include RCS, from participating in a public offering of a REIT unless such offering conforms to specified conditions. *See* Rule 2310(b)(1).

One condition is the requirement that "the organization and offering expenses are [] fair and reasonable, taking into consideration all relevant factors." Rule 2310(b)(4)(A). Under FINRA rules, such expenses are *unfair* and *unreasonable* if "the total amount of all items of compensation from whatever source . . . *exceeds an amount that equals ten percent of the gross proceeds of the offering* . . . ." Rule 2310(b)(4)(B)(ii) (emphasis added). Thus, while the Trust contends that the 10% compensation available to RCS (to be shared with FINRA member retail broker-dealers who act as selling group members and their financial advisors) is unsustainable (Compl. ¶ 5), that percentage represents the *maximum* fee that FINRA rules authorize. *See* Rule 2310(b)(4)(B)(ii). Every industry participant knows of these FINRA rules and the constraints under which FINRA members operate.[12]

The Trust contends that the defendants breached their fiduciary duties because RCS should have also insisted upon a piece of the *management fees* for the REITs that RCS distributed. RCS, though, did not act as the sponsor, advisor or manager for those REITs (and the Trust does not allege that it did), and thus RCS had no entitlement to such fees. Further, allowing a distributor to obtain a portion of unearned management fees from the REIT would violate the FINRA rule limiting compensation to no more than 10% of proceeds raised.

FINRA prohibits REIT wholesalers from obtaining additional compensation above 10%, particularly in the form of supposed "management

[12] Indeed, as noted above, numerous critics of Rule 2310 say that brokers are permitted far too much compensation with respect to REIT offerings.

fees." Thus, under Rule 2310, expenses are *unfair* and *unreasonable*, and therefore prohibited, if:

> the program or REIT provides for *compensation of an indeterminate nature to be paid to members* or persons associated with members for sales of the program or REIT, or for services of any kind rendered in connection with or related to the distribution thereof, *including* . . . a *percentage of the management fee* . . . .

Rule 2310(b)(4)(B)(v) (emphasis added). Rule 2310 thus prohibits precisely what the Trust argues RCS should have received—indeterminate additional compensation in the form of a percentage of management (or advisory) fees.

A breach of fiduciary duty claim cannot rest on a fiduciary's unwillingness to violate the law; thus, it cannot rest on defendants' decision to refrain from using their influence as RCAP directors or officers to cause RCS to violate FINRA regulations. *See Milliner* v. *Mut. Sec., Inc.*, 207 F. Supp. 3d 1060, 1070 (N.D. Cal. 2016) (where FINRA rules require a member to perform certain functions, such member cannot claim to be relieved from those obligations through private agreement); *see also Metro Commc'n Corp. BVI* v. *Advanced Mobilecomm Techs. Inc.*, 854 A.2d 121, 131 (Del. Ch. 2004) ("Under Delaware law, a fiduciary may not choose to manage an entity in an illegal fashion, even if the fiduciary believes that the illegal activity will result in profits for the entity."); *Teamsters Union 25 Health Servs. & Ins. Plan* v. *Baiera*, 119 A.3d 44, 70 (Del. Ch. 2015) (under Delaware law, "'one cannot act loyally as a corporate director by causing the corporation to violate the positive laws it is obliged to obey'") (quoting *Guttman* v. *Huang*, 823 A.2d 492, 506 n.34 (Del. Ch. 2003)).

Under these authorities, no basis exists as a matter of law and common sense for the Trust's allegation that the Individual ARC Defendants and Holdings somehow breached fiduciary duties owed to RCAP by not causing RCS to adopt a compensation structure that would violate the law.

The Trust alleges that other wholesale broker-dealers—Strat Cap and PECO, a Phillips Edison-owned entity—received a portion of REIT management fees. (Compl. ¶¶ 49-50.) Both examples involve irrelevant apples-to-oranges comparisons. Strat Cap, as disclosed in public filings, performs management and operational services through an affiliated advisor; it is for those services, not for wholesale services, that it receives a portion of management fees. (*See* Arffa Aff. Ex. 8; Arffa Aff. Ex. 9.) And in the PECO example, a Phillips Edison entity served as a sub-advisor, given its special expertise in the grocery industry which was used to assist in the REIT's operation. (Compl. ¶ 50.) Phillips Edison was paid for the sub-advisory services for which it was engaged.

Thus, unlike RCS, Strat Cap and PECO each performed management or advisory functions and received compensation for those services. By contrast, RCS acted *only* as a distributor or wholesaler for REIT offerings. As a result, under Rule 2310, RCS was prohibited from earning management or advisory fees.

See Rule 2310(b)(4)(B)(v). The Trust's breach of fiduciary duty claim cannot survive because it alleges the ARC Parties (through RCAP) should have caused RCS to earn fees for work RCS did not perform.

Adding to the illogic of the Trust's claim is the fact that RCAP purchased Strat Cap, something the Trust concedes. Thus, if the Trust maintains that RCAP should have pursued Strat Cap's model of acting both as a REIT wholesaler and advisor, it did so. *See DiRienzo* v. *Lichtenstein*, 2013 WL 5503034, at *16 (Del. Ch. Sept. 30, 2013) (claim not "reasonably conceivable" where relied on "contradictory allegations"). At the least, it is clear that the defendants did not prevent RCAP (or RCS) from pursuing such an arrangement where appropriate.

3. RCS's Supposedly "Inherently Unprofitable" Business Model Was Fully Disclosed to Investors and Sophisticated Investment Professionals (Including Luxor, the Force Behind The Trust's Complaint) Who Embraced It

The Trust's claim that the Individual ARC Defendants and Holdings violated duties owed to RCAP by requiring RCS to do business in an "inherent[ly] unprofitab[le]" manner that "no third party wholesaler . . . would accept" (*see* Compl. ¶¶ 47-48) is also not reasonably conceivable and should also be dismissed. Specifically:

-- the complained-of arrangements at RCS were fully disclosed to the financial markets and investors, who nevertheless supported and invested in RCAP. Clearly these investors, many of whom, like

> Luxor, were highly sophisticated, did not believe RCAP was doomed to fail as a result;
>
> -- several of the Individual ARC Defendants and Holdings retained a significant interest in RCAP. This too would make no sense if these defendants intentionally set RCAP up to lose money; and
>
> -- the 1-2% that RCS earned would surely have been profitable at some level of sales. It is patently implausible to state that any percentage was "inherently unprofitable."

Given these facts, the Trust's unsupported allegations should be dismissed. *See In re Gen. Motors*, 897 A.2d at 169-70 (court need not accept as true unsupported allegations contradicted by publicly available facts); *Malpiede*, 780 A.2d at 1083 ("[T]he trial court is not required to accept every strained interpretation of the allegations proposed by the plaintiff . . .").

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For all of these reasons, the Trust's breach of fiduciary duty claims with respect to the business model of RCAP's subsidiary RCS fail.

B. The Breach of Fiduciary Duty Claim Based on RCS's Employment Decisions Also Fails

The Complaint also alleges a breach of fiduciary duty based on RCS staffing decisions. Specifically, it contends that the Individual ARC Defendants (presumably, through their positions at RCAP or RCS) caused RCS to overspend on staffing and other matters, to RCAP's detriment and to benefit their own interests in AR Capital. These allegations are unsustainable.

1. What the Trust Really Alleges Is Corporate Waste, a Claim Its Allegations Cannot Support

The Trust claims that the Individual ARC Defendants and Holdings breached fiduciary duties to RCAP based on RCS's purported overstaffing and excessive expenditures. The Court should see all of this for what it is: a claim for corporate waste, not a claim for breach of fiduciary duties. *Cf. In re Comverge, Inc. S'holders Litig.*, 2014 WL 6686570, at *13 (Del. Ch. Nov. 25, 2014) (recognizing a claim stylized as a duty of loyalty breach was properly considered as a breach of the duty of care subject to an exculpation clause). Indeed, at one point, the Trust *admits* the true nature of this claim: it asserts that the Individual ARC Defendants and Holdings "[*w*]*ast*[*ed*] *corporate assets* by forcing RCAP to wildly overstaff [RCS]." (Compl. ¶ 129 (emphasis added).)

To plead corporate waste, the Trust must allege "that 'the [transactions] in question either served no corporate purpose or [were] so completely bereft of consideration that [they] effectively constituted a gift.'" *In re Limited, Inc. S'holders Litig.*, 2002 WL 537692, at *8 (Del. Ch. Mar. 27, 2002) (citation omitted); *Lewis* v. *Vogelstein*, 699 A.2d 327, 336 (Del. Ch. Mar. 11, 1997). The Trust cannot meet that bar.

Profitability in the wholesale broker business depends on high-volume distribution, as the Trust admits. (Compl. ¶ 61.) The Trust also admits that a larger sales force and greater expenditures produce more sales. (*Id.* ¶ 67 ("[M]ore salespeople spending more money *produced more sales* . . . .") (emphasis added).) While the complained-of staffing and expenditures might well help AR Capital business make money (because RCS, in part, distributed AR Capital products) it cannot be disputed that the very same additional sales would help RCS (and hence RCAP) make money. Thus, the Trust's disguised corporate waste claim fails. *See In re Limited, Inc.*, 2002 WL 537692, at *8.

2. The Trust Has Not Pleaded a Breach of the Duty of Loyalty

Knowing it cannot sustain a corporate waste claim, the Trust recasts its "overstaffing" claim as a breach of the duty of loyalty, claiming—without explaining how—that the staffing decisions at RCS were driven by improper and disloyal motives by the Individual ARC Defendants and Holdings. That claim fails.

First, even with all reasonable inferences drawn in the Trust's favor, there is no "reasonable possibility" that the Trust could prevail on a claim for breach of the duty of loyalty to RCAP based on employment decisions at RCS. The Trust's theory *unreasonably* requires the Court to conclude that these defendants would act contrary to their economic interests. *See In re Gen. Motors Class H S'holders Litig.*, 734 A.2d 611, 617-18 (Del. Ch. 1999). During at least part of the relevant period, Mr. Weil served as CEO of RCAP, Ms. Quarto served as President of RCS, and Holdings' "principal asset" consisted of its interests in

RCAP. (Compl. ¶¶ 16, 19, 23.) These alleged facts suggest that these defendants' interests were always aligned with the interests of RCAP and RCS.

During the same period, Mr. Weil's interest in AR Capital was only 3.51% and Ms. Quarto did not have *any* interest in AR Capital. (*Id.*) Those allegations do not provide a basis for reasonably inferring that these defendants' interest in AR Capital was so material to these defendants that they would run RCS into the ground to benefit AR Capital. *See Trenwick*, 906 A.2d at 210 ("[G]iven that the . . . directors who were employees presumably wished to remain employed by a solvent entity—it is well-nigh impossible to draw an inference that these defendants knew they were being stupid and putting the company (and for some of them, their livelihoods) at stake.").

Even for the defendants who allegedly held a larger interest in AR Capital, driving RCS (or RCAP) into the ground runs contrary to their self-interest. According to the Trust, RCS "was a *necessary part* of the REIT pipeline and therefore *critical* to AR Capital's profits." (Compl. ¶ 41 (emphasis added).) Indeed, the Complaint stresses that "[*w*]*ithout RCAP to bring in the money, AR Capital would be nothing.*" (*Id.* ¶ 2 (emphasis added).) The idea that the Individual ARC Defendants would jeopardize the "critical" pipeline for AR Capital products assumes irrational behavior. The Court need not, and should not, draw such illogical inferences. *See Trenwick*, 906 A.2d at 185, 210.

Furthermore, additional sales of AR Capital products would increase revenues at RCS, as noted above. Thus, no basis exists for inferring that hiring additional (primarily commission based) employees to drive additional sales would somehow be detrimental to RCS or its parent RCAP. In short, the Complaint simply makes no sense on this point.

Second, the Complaint fails to allege any actual wrongdoing by any defendant in connection with the purported overstaffing of RCS that would support a claim for breach of the duty of loyalty. *Cf. In re Alloy, Inc.*, 2011 WL 4863716, at *9 (Del. Ch. Oct. 13, 2011) (allegations that do not identify a majority of directors are an insufficient basis to infer disloyalty of any other decision makers). There are only two allegations purportedly supporting the Trust's overstaffing claim: (1) Ms. Quarto was aware that RCS had more salespeople than its competitors, which, according to the Trust, "should have rung alarm bells" (Compl. ¶ 65); and (2) Mr. Weil corresponded with RCS CEO Dwyer about driving RCS's sales by focusing on client events and compensation incentives (*id.* ¶ 66). Neither allegation supports a claim for breach of fiduciary duty. *Cf. In re Caremark Int'l Inc. Derivative Litig.,* 698 A.2d 959, 968 (Del. Ch. 1996) ("Most of the decisions that a corporation, acting through its human agents, makes are, of course, not the subject of director attention."); *Rosenblatt* v. *Getty Oil Co.*, 493

A.2d 929, 943 (Del. 1985) ("The realities of modern corporate life are such that directors cannot be expected to manage the day-to-day activities of a company.").

3. The Trust's Claim Fails Under the Business Judgment Rule and Exculpatory Provisions of RCS's Certificate of Incorporation

Nor could the Trust's "overstaffing" allegations support a claim for breach of the duty of care. Absent any pleaded facts supporting a claim for breach of the duty of loyalty, the business judgment rule presumes that defendants made their staffing decisions in good faith. *See, e.g., Solomon* v. *Armstrong*, 747 A.2d 1098, 1111-12 (Del. Ch. Mar. 25, 1999) (dismissal appropriate where complaint failed to overcome the business judgment rule presumption), *aff'd*, 746 A.2d 277 (Del. 2000) (TABLE).

Moreover, as noted above, the Company's charter exculpates the director defendants from liability to the full extent of Delaware law. Hence, they are exculpated, other than for breaches of the duty of loyalty, bad faith, or actions involving "intentional misconduct or a knowing violation of law" or self-interestedness. *See* 8 *Del. C.* § 102(b)(7); (Arffa Aff. Ex. 5 § 8.01.) Because the Complaint contains no such allegations, the director defendants—Messrs. Schorsch, Kahane, Weil, and Budko (as well as Mr. Block)—are further insulated from any claim of personal liability for routine business decisions such as determining the appropriate level of staffing and compensation. *See id.*

C. The Allegations in the Complaint Concerning the Purchase of Strategic Capital Partners, SK Research, and Docupace Technologies Cannot Support a Fiduciary Duty Claim

The remainder of the Trust's "kitchen sink" allegations of breach of fiduciary duty concerns various acquisitions made by RCAP. None of these matters supports any such claim.

Specifically, the Complaint strains to find a breach of the Individual ARC Defendants' (and presumably Holdings') supposed fiduciary duties to RCAP in RCAP's acquiring of Strat Cap, SK Research and Docupace Technologies. In particular, it asserts, largely in a conclusory manner, that the Individual ARC Defendants (at least those sitting on the Board of Directors or as an officer of RCAP at the relevant time) caused RCAP to enter into these transactions for AR Capital's benefit (and thus themselves), not for RCAP's benefit. (Compl. ¶ 129.) These allegations cannot support a breach of fiduciary duty claim.

First, the business judgment rule protects these decisions to enter into these transactions, a presumption of good faith that the Trust has not rebutted. To overcome the business judgment rule's good-faith presumption, a complaint must "plead facts demonstrating that a majority of a board that approved the transaction in dispute was interested and/or lacked independence." *Orman* v. *Cullman*, 794 A.2d 5, 23 (Del. Ch. 2002). The test "requires the application of a subjective 'actual person' standard to determine whether a *particular* director's interest is material and debilitating or that he lacks independence because he is controlled by another." *Id.* at 24 (emphasis in original; citation omitted). The Trust does not meet this burden.

There is no allegation that any of these transactions were self-dealing transactions; none of the ARC Individual Defendants were "on both sides of [the] transaction[s] nor expect[ed] to derive any personal financial benefit from [them]." *Aronson* v. *Lewis*, 473 A.2d 805, 812 (Del. 1984) (citation omitted), *overruled on other grounds by Brehm* v. *Eisner*, 746 A.2d 244 (Del. 2000).

Absent self-dealing, a plaintiff must sufficiently allege that a director received a *material* benefit not equally shared by the stockholders. *Orman*, 794 A.2d at 23. The materiality requirement is a stringent one: it requires a plaintiff to plead that "in the context of the director's economic circumstances," it was "improbable that the director could perform her fiduciary duties to the . . . shareholders without being influenced by her overriding personal interest." *In re Gen. Motors Class H S'holders Litig.*, 734 A.2d at 617; *see Pfeffer* v. *Redstone*, 965 A.2d 676, 690 (Del 2009) (duty of loyalty claim properly dismissed where no allegation that directors stood on both sides of a transaction and no non-conclusory allegation of a "unique financial benefit to the exclusion of the shareholders"). The Trust fails to meet these criteria.

The Complaint does not allege that, by virtue of any of the three transactions, any of the Individual ARC Defendants received a material benefit unavailable to RCAP. Even as to Mr. Schorsch, who owned a controlling interest in AR Capital (Compl. ¶ 17), there are no allegations that he would receive any material benefit through his interest in AR Capital, or any other benefit accruing to him beyond the benefits accruing to other RCAP shareholders. *See Pfeffer*, 965 A.2d at 690.

As for the other Individual ARC Defendants, each only owned a membership interest in AR Capital of between 3.03% and 16.4% or, in the case of Ms. Quarto, no interest at all. (Compl. ¶¶ 18-23.) The Complaint does not present any facts supporting an inference that the Individual ARC Defendants were so biased in AR Capital's favor that they could not perform their fiduciary duties to RCAP. *See In re Gen. Motors Class H S'holders Litig.*, 734 A.2d at 617 (fact that directors owned greater amount of one class of stock than another was not material enough to make it improbable that directors could not perform their fiduciary duties to owners of the second class of stock).

Nor does the Trust allege that any of the Individual ARC Defendants or Holdings lacked independence in connection with these transactions. *See Orman*, 794 A.2d at 24 (plaintiff "must allege [lack of independence with] particularized facts") (quoting *Aronson*, 473 A.2d at 816) (internal quotations omitted). Conclusory allegations that directors are "dominated and controlled" (*id.*) are insufficient; rather, the plaintiff must plead "facts that establish 'that the directors are 'beholden' to [the controlling person] or so under their influence that their discretion would be sterilized.'" *Id.* (quoting *Rales* v. *Blasband*, 634 A.2d 927, 936 (Del. 1993). The complaint fails to meet this burden.[13]

Second, the allegations concerning these transactions are internally inconsistent, nonsensical, demonstrably wrong, or all of the foregoing, as shown below:

(a) The Strat Cap Acquisition

The Trust alleges that the Individual ARC Defendants caused RCAP to acquire Strat Cap for an inflated price for their own benefit, because, it alleges, doing so would eliminate a competitor of AR Capital and "open[] up new lines of distribution for AR Capital products by providing access to national, full-service broker-dealers . . . .'" (Compl. ¶¶ 10, 90, 91.)

As another "wholesale distributer of non-traded products" (*Id.* ¶ 90), Strat Cap would have competed with RCS at least as much as—if not more than—it competed with AR Capital. Thus, any purported benefit accruing to AR Capital by eliminating Strat Cap as a competitor would accrue to RCS as well. In addition,

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[13] For similar reasons, the complaint fails to plead a non-exculpated claim against the director defendants as to these transactions. *See In re Comverge*, 2014 WL 6686570, at *13.

the acquisition of additional national full-service broker dealers that could provide "new lines of distribution" would have enabled both RCS and Strat Cap itself (once under RCAP's ownership) to distribute additional products, obtain additional commissions and ultimately achieve additional revenues. In short, there is no plausible allegation that this transaction would have benefited AR Capital at RCAP's expense.

The Trust's claim that the Individual ARC Defendants concealed information about Strat Cap's business to manipulate RCAP into making the acquisition is also wrong. (*See Id.* ¶¶ 56, 92.) The so-called "hidden" information that, unlike RCS, Strat Cap also served as an advisor to REITs whose securities it distributed, is in fact found in RCAP's own public filings.

On May 20, 2014—well before the transaction closed in September 2014—RCAP stated in a public filing that it had entered into an agreement to acquire Validus/Strategic Capital Partners, LLC, an entity with two distinct wholly-owned subsidiaries: (1) Strat Cap, which "provides *advisory and operational services* with respect to non-exchange traded direct investment products," and (2) SC Distributors, LLC, which "is a financial services distribution organization focused on direct investment products." (Arffa Aff. Ex. 8 (emphasis added).) An investor presentation enclosed with that filing recites that "Strat Cap's subsidiaries *co-sponsor* and serve as the wholesale distributor for a platform consisting of two of non-traded REITs, a non-traded BDC, a public non-traded LLC and a non-traded C-Corp." (Arffa Aff. Ex. 10, at 3.) And in the same vein, the accompanying press release described Strategic Capital Advisory Services as "a provider of *advisory* and operational services to non-exchange traded alternative investment vehicles." (Arffa Aff. Ex. 11 (emphasis added).) Thus, Strat Cap's role as an advisor—the very information the Trust claims was concealed—was clearly disclosed by RCAP and known to its investors.

(b) SK Research

The Trust next alleges that the hiring of Todd Snyder and John Kearney, and the resulting creation of SK Research, a due diligence provider, was "similarly intended only to serve the interests of the Control Defendants" by "defang[ing] a critic of AR Capital products." (Compl. ¶ 95.) But even if "defanging a critic" (whatever that means) could be a viable basis for a breach of fiduciary duty claim, any benefit it might cause would also accrue to RCAP's subsidiary, RCS, which concededly distributed AR Capital products. (*Id.* ¶ 41.)

(c) Docupace Technologies

Finally, the Trust alleges that RCAP's acquisition of Docupace, a software provider, "was another transaction that served only AR Capital's interests." (*Id.* ¶ 102.) The AR Capital interest purportedly advanced was "developing software that could induce smaller retail broker-dealers to sell [AR Capital's] products." (*Id.*)

As the Complaint alleges, AR Capital distributed its products through RCS as wholesale broker-dealer, to retail broker-dealers. (*See Id.* ¶¶ 2, 45.) Encouraging retail broker-dealers to sell AR Capital products for which RCS was the wholesale distributor was a significant part of how RCS made money. (*Id.* ¶ 45.) Thus, any economic benefit from the Docupace transaction would have flowed to RCS (and ultimately RCAP) at least as much as to AR Capital.

D. Supposed Misconduct by a Handful of RCS Employees Cannot Support a Fiduciary Duty Claim

Finally, the Trust claims that the Individual ARC Defendants and Holdings somehow provoked a proxy fraud by *RCS* employees that led *RCAP's* outside attorneys to negotiate a consent agreement with the Enforcement Section of the Massachusetts Securities Division (the "MSD"). There are no facts alleged in the Complaint supporting an inference of any wrongdoing on the part of any ARC Party with respect to this incident.

The MSD investigated the proxy fraud incident underlying this claim, which ultimately led to RCS's paying $3 million in fines. Notably, the misconduct the MSD identified was misconduct by isolated *employees of RCS*, not by any of the defendants. Neither the MSD, nor any other regulator (or other party) has found any wrongdoing on the part of any ARC Party in connection with the proxy fraud, and no fines or other penalties were ever leveled against any of the ARC Parties in connection with this incident. In fact, even an internal investigation that RCAP's outside counsel conducted uncovered improper conduct only at RCS, not AR Capital. (Compl. ¶ 118.) As a result, not surprisingly, the Trust fails to allege a single instance of wrongdoing by any ARC Party to support its claim.

Indeed, the Trust simply alleges that: (1) AR Capital, with Apollo, purportedly paid RCAP $375,000 to perform proxy solicitation services, and (2) "the Control Defendants and their minions placed extraordinary pressure on [RCS] employees to deliver the required proxies —which were plainly for the benefit of AR Capital and Apollo, not RCAP." (*Id.* ¶ 116.) Even if true, paying for services rendered and setting time sensitive business goals are not breaches of fiduciary duty.

In short, there is simply no specific factual allegation of any improper conduct on the part of any specific ARC Party as to this issue. Thus, the allegations are woefully insufficient, and this claim too should be dismissed.[14]

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[14] It is a far stretch to infer a duty of care claim based on these allegations. However, if the Court was to give the Trust that benefit of the doubt, the claim would still fail under the business judgment rule and be barred as to the director defendants by the exculpatory clause in the RCAP charter. *Supra* at 38.

II.
THE TRUST'S CLAIM FOR AIDING AND ABETTING BREACH OF FIDUCIARY DUTY (COUNT II) SHOULD BE DISMISSED

Count II of the complaint asserts a claim for aiding and abetting breach of fiduciary duty against Holdings, Schorsch, Kahane, Weil, Budko, Block and Quarto as an alternative to Count I's breach of fiduciary duty claim "to the extent any or all of" the defendants named in those counts "are determined not to have owed direct fiduciary duties of care and loyalty." (Compl. ¶ 132.) The pleading of the aiding and abetting breach of fiduciary claim is wholly inadequate, and the claim should be dismissed.

A. The Aiding and Abetting Claim Should Be Dismissed Because the Underlying Fiduciary Duty Claim Is Legally Insufficient

To begin with, a claim for aiding and abetting breach of fiduciary duty cannot proceed in the absence of any underlying breach of fiduciary duty. *AM Gen. Holdings LLC* v. *Renco Grp., Inc.*, 2013 WL 5863010, at *12 (Del. Ch. Oct. 31, 2013); *In re Alloy*, 2011 WL 4863716, at *14. Because the Trust's breach of fiduciary duty claim is legally insufficient, the Trust's claim for aiding and abetting breach of fiduciary duty fails. *Madison Realty Partners 7, LLC* v. *AG ISA, LLC*, 2001 WL 406268, at *6 n.19 (Del. Ch. Apr. 17, 2001) ("The plaintiffs' claim . . . for aiding and abetting . . . breaches of fiduciary duty must also be dismissed because there is no legally sufficient underlying claim for breach of fiduciary duty . . . ."); *In re Crimson Expl. Inc. Stockholder Litig.*, 2014 WL 5449419, at *27

(Del. Ch. Oct. 24, 2014) ("Because the underlying breaches of fiduciary duty are being dismissed, Plaintiffs' aiding and abetting claim must be dismissed as well.") (citation omitted).

B. The Aiding and Abetting Claim Should Be Dismissed Because the Complaint Fails to Allege any Defendant's "Knowing Participation" in an Alleged Breach of Duty

Even if the Trust's breach of fiduciary duty claim were legally sufficient (and it is not), the Trust's aiding and abetting breach of fiduciary claim still fails to state a claim. An aiding and abetting breach of fiduciary duty claim requires: "(i) the existence of a fiduciary relationship, (ii) a breach of the fiduciary's duty, (iii) knowing participation in that breach by the defendants, and (iv) damages proximately caused by the breach." *RBC Capital Mkts., LLC* v. *Jervis*, 129 A.3d 816, 861 (Del. 2015) (citation omitted). Here, the Trust utterly fails to allege, as to any of the ARC Parties, the "knowing participation" element of its claim.

"Knowing participation" is "a 'stringent' standard that 'turn[s] on proof of scienter.'" *Lee* v. *Pincus*, 2014 WL 6066108, at *13 (Del. Ch. Nov. 14, 2014) (citation omitted). "The aider and abettor must act knowingly, intentionally, or with reckless indifference; that is, with an illicit state of mind." *RBC Capital Mkts., LLC*, 129 A.3d at 862 (citation, internal quotations & alterations omitted). To show scienter, a complaint must contain allegations that the defendants had "actual or constructive knowledge that their conduct was legally improper." *Wood* v. *Baum*, 953 A.2d 136, 141 (Del. 2008) (citation & internal quotations omitted).

Knowing participation may be inferred if "the terms of [a] transaction are so egregious or the magnitude of side deals is so excessive as to be inherently wrongful"; "it appears that the defendant may have used knowledge of the breach to gain a bargaining advantage in the negotiations"; or "the defendant sought to induce the breach of fiduciary duty, such as through the offer of side payments intended as incentives for the fiduciaries to ignore their duties." *In re Telecomms., Inc. S'holders Litig.*, 2003 WL 21543427, at *2 (Del. Ch. July 7, 2003) (citations omitted); *accord In re Novell, Inc. S'holder Litig.*, 2013 WL 322560, at *17-18 (Del. Ch. Jan. 3, 2013).

An aiding and abetting breach of fiduciary duty claim based only on "conclusory statements that are devoid of factual details to support an allegation of knowing participation" cannot survive. *McGowan* v. *Ferro*, 2002 WL 77712, at *2 (Del. Ch. Jan. 11, 2002) (citation & internal quotations omitted). Delaware courts routinely dismiss such claims at the pleading stage in the absence of plausible allegations of a defendant's knowing participation. *See, e.g.*, *In re Novell, Inc.*, 2013 WL 322560, at *17-18; *In re Telecomms., Inc.*, 2003 WL 21543427, at *4.

Here, the Trust does not allege a single fact supporting an inference of knowing participation by any of the defendants named in Count II. The Complaint nowhere sets out any facts showing that any of those defendants acted with "an illicit state of mind." *RBC Capital Mkts., LLC*, 129 A.3d at 862 (citation & internal quotations omitted). Nor does it anywhere suggest that any of the defendants acted in an "inherently wrongful" manner, that they "used knowledge of [a] breach [of fiduciary duty by fiduciaries] to gain a bargaining advantage," or that they "sought to induce [a] breach of fiduciary duty [by any fiduciaries]." *In re Telecomms., Inc.*, 2003 WL 21543427, at *2 (citations omitted).

Instead, the Trust, in all but one paragraph, alleges merely that the defendants at issue "knowingly participated in breaches of fiduciary duty by other defendants and thus [are] liable for aiding and abetting such breaches." (Compl. ¶ 132.) But merely reciting the elements of a claim without any factual support does not state a viable claim under Delaware law. *See Spring Real Estate, LLC* v. *Echo/RT Holdings, LLC*, 2013 WL 6916277, at *7 (Del. Ch. Dec. 31, 2013) ("The Complaint does not state a claim . . . because the[] allegations are conclusory and mere recitations of the . . . statute.") (citation omitted); *Hospitalists of Del., LLC* v. *Lutz*, 2012 WL 3679219, at *13 (Del. Ch. Aug. 28, 2012) ("[E]ven under Delaware's minimal notice pleading standard, simply reciting the statutory or common law elements of an offense, as Plaintiffs have here, is insufficient to state a claim upon which relief may be granted.") (citation omitted).

Because the Trust's aiding and abetting breach of fiduciary claim rests on just such an impermissible recitation, it should be dismissed.

III.
THE TRUST'S CLAIM FOR UNJUST ENRICHMENT AND CONSTRUCTIVE TRUST (COUNT III) SHOULD BE DISMISSED

Count III of the Complaint (a) asserts a claim for unjust enrichment and (b) seeks imposition of a constructive trust against AR Capital, its successor AR Global, and the Advisor Defendants. Both aspects of Count III fail.

A. The Trust Has Failed to State an Unjust Enrichment Claim

1. The Trust Has No Claim for Unjust Enrichment Against the Advisor Defendants Because Contracts Exist That Govern the Relationship

To begin with, the unjust enrichment claim is legally barred as against the Advisor Defendants. Delaware law precludes "[a] claim for unjust enrichment . . . if there is a contract that governs the relationship between parties that gives rise to the unjust enrichment claim." *Kuroda* v. *SPJS Holdings, L.L.C.*, 971 A.2d 872, 891 (Del. Ch. 2009). Thus, "when the complaint alleges an express, enforceable contract that controls the parties' relationship a claim for unjust enrichment will be dismissed." *Id.* (citations, internal quotations & alterations omitted); *see also Vichi* v. *Koninklijke Philips Electronics N.V.*, 62 A.3d 26, 58 (Del. Ch. 2012) ("It is a well-settled principle of Delaware law that a party cannot recover under a theory of unjust enrichment if a contract governs the relationship between the contesting parties that gives rise to the unjust enrichment claim.") (citations omitted);

Bakerman v. *Sidney Frank Importing Co.*, 2006 WL 3927242, at *18 (Del. Ch. Oct. 16, 2006) ("When the complaint alleges an express, enforceable contract that controls the parties' relationship[,] a claim for unjust enrichment will be dismissed." (citations omitted)); *Albert* v. *Alex. Brown Mgmt. Servs., Inc.*, 2005 WL 2130607, at *8 (Del. Ch. Aug. 26, 2005) (dismissing unjust enrichment claim "when the existence of a contractual relationship [was] not controverted").

RCS and each of the Advisor Defendants are parties to a DMA in which RCS agreed to be each REIT's exclusive distributor in consideration of the maximum underwriting compensation available under FINRA rules. (*See, e.g.*, Arffa Aff. Ex. 1 ¶ 3(d); Arffa Aff. Ex. 2 ¶ 3(d).) Each DMA specified that pursuant to Rule 2310, the "total aggregate compensation" payable to RCS was 10% of the REIT's gross offering proceeds. (*See, e.g.*, Arffa Aff. Ex. 1 ¶ 3(d)(iv); Arffa Aff. Ex. 2 ¶ 3(d)(iv).) The DMAs also contain an integration clause precluding other compensation terms, and a forum clause providing New York as the exclusive forum for related disputes. (*See, e.g.*, Arffa Aff. Ex. 1 ¶ 11(f),(j); Arffa Aff. Ex. 2 ¶ 11(f),(j) (BDCA DMA).)

Accordingly, because the DMAs govern RCS's relationship with the Advisor Defendants, RCS cannot assert a claim for unjust enrichment against the Advisor Defendants, and the Trust's claims against those defendants should be dismissed. *See, e.g.*, *Bakerman*, 2006 WL 3927242, at *18-19 (dismissing unjust enrichment claim where the parties had an express contract); *In re Lear Corp. S'holder Litig.*, 967 A.2d 640, 657 (Del. Ch. 2008) (same).

2. The Trust's Claim for Unjust Enrichment Fails Because the Complaint Does Not Plausibly Allege the Breach of a Duty or that RCAP Was "Unjustly Impoverished"

In addition, the Trust's unjust enrichment claim fails on its merits as against all of the defendants named in Count III. Unjust enrichment is "the unjust retention of a benefit to the loss of another, or the retention of money or property of another against the fundamental principles of justice or equity and good conscience." *Fleer Corp.* v. *Topps Chewing Gum, Inc.*, 539 A.2d 1060, 1062 (Del. 1988) (citation & internal quotations omitted). A legally viable unjust enrichment claim must allege: "(1) an enrichment, (2) an impoverishment, (3) a relation between the enrichment and impoverishment, (4) the absence of justification, and (5) the absence of a remedy provided by law." *Nemec* v. *Shrader*, 991 A.2d 1120, 1130 (Del. 2010) (citations omitted). The Trust's unjust enrichment claim does not allege these essential elements.

The Complaint contends that AR Capital, its successor AR Global and the Advisor Defendants were unjustly enriched because they supposedly "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;" that

RCAP was "unjustly impoverished" as a result of those purported actions; and that "[t]he unjust shifting of value from RCAP to defendants was not justified, unfair, and inconsistent with ordinary commercial practice." (Compl. ¶¶ 135-37.)

The Trust's theory appears to be that the supposed breach of fiduciary duty to RCAP on the part of the Individual ARC Defendants and Holdings in connection with RCS's allegedly unfair business model somehow unjustly enriched AR Capital, AR Global and the Advisor Defendants. Yet, the Complaint fails to state a claim for breach of fiduciary duty in connection with the RCS business model and fee structure, *see supra* at 25-33, so there is no basis for inferring that AR Capital, AR Global and the Advisor Defendants were unjustly enriched as a result of any such breach.

In any event, the Trust does not allege a single fact supporting the unlikely proposition that RCS was somehow "impoverished" by not receiving compensation for management and advisory services that it did not perform. While the Trust alleges that RCS should have been permitted to negotiate agreements for management and advisory services, it does not allege that it actually did any of the work for which advisors and subadvisors are compensated. Such circumstances do not amount to "impoverishment."

The Trust has equally failed to allege any facts about what AR Capital, AR Global and the Advisor Defendants did to enrich themselves at RCS's expense. Rather, it appears that these defendants were simply paid and received appropriate compensation for services they actually performed. That is not unjust enrichment.

In addition, it is not enough for the Trust to maintain generally that RCS was supposedly impoverished because of an allegedly improper business arrangement, without specifying the role that AR Capital, AR Global and the Advisor Defendants actually played in devising that arrangement and how those particular parties were enriched *as a result* of the consequent impoverishment. *See MetCap Secs. LLC* v. *Pearl Senior Care, Inc.*, 2007 WL 1954442, at *2 (Del. Ch. June 29, 2007) ("There must be some relationship or connection between that enrichment and impoverishment. Without some relationship, it is difficult to understand why the recipient's retention of the benefit would constitute an 'injustice.'") (citations omitted); *see also Teamsters Local 237 Welfare Fund* v. *Astrazeneca Pharm. LP*, 2015 WL 4111826, at *9 (Del. Super. Ct. July 8, 2015) ("Plaintiffs fail to establish a causal connection between the alleged 'enrichment' and the alleged 'impoverishment' in this case. Accordingly, the [complaint] fails to state a claim for unjust enrichment and must, therefore, be dismissed."), *aff'd*, 136 A.3d 688 (Del. 2016). The Complaint utterly fails to allege this critical information as well.

For all of these reasons, the Complaint fails to state a claim for unjust enrichment against AR Capital, AR Global and the Advisor Defendants.

B. The Trust's Request for a Constructive Trust Should Be Rejected Because the Unjust Enrichment Claim Fails

The Trust also fails to allege facts necessary to support its request for constructive trust.

A constructive trust is a remedy "secondary to, and derivative of, [an] underlying unjust enrichment claim." *VTB Bank* v. *Navitron Projects Corp.*, 2014 WL 1691250, at *6 (Del. Ch. Apr. 28, 2014). The showing necessary to sustain a request for a constructive trust is even greater than that required for unjust enrichment. Indeed, "a[] constructive trust is available to a plaintiff *only* where a defendant has unjustly enriched itself at the expense of another to whom it owes some duty as the result of *fraudulent or unfair and unconscionable conduct*." *Nash* v. *Schock*, 1997 WL 770706, at *6 (Del. Ch. Dec. 3, 1997) (emphasis added & citation omitted), *aff'd*, 732 A.2d 217 (Del. 1999).

Accordingly, because the Trust has failed to plead a claim for unjust enrichment against any of the defendants named in that claim, its constructive trust request should necessarily be rejected. *See, e.g.*, *Vornado PS, L.L.C.* v. *Primestone Inv. Partners, L.P.*, 821 A.2d 296, 322 (Del. Ch. 2002) (rejecting request for a constructive trust because plaintiff was required to but did not establish unjust enrichment), *aff'd*, 822 A.2d 397 (Del. 2003) (TABLE); *Khoury Factory Outlets,* *Inc.* v. *Snyder*, 1996 WL 74725, at *11 (Del. Ch. Jan. 8, 1996) (rejecting request to impose a constructive trust because there was "no basis in the . . . record to establish unjust enrichment").

Further, consistent with above authorities, a constructive trust also requires "fraud or a breach of duty arising out of a confidential or fiduciary relationship." 90 C.J.S. Trusts § 11 (2017) (citation omitted); *see Prestancia Mgmt. Grp., Inc.* v. *Va. Heritage Found., II LLC*, 2005 WL 1364616, at *6 (Del. Ch. May 27, 2005). Here, the Trust has alleged only a contractual relationship between RCAP and the Advisor Defendants, and no relationship between RCAP and AR Capital and AR Global. The Trust has not alleged fraud, and the publicly available DMAs explicitly disclaim the existence of any fiduciary relationship which in any event, the Trust does not allege with respect to AR Capital, AR Global, or the Advisor Defendants. (*See e.g.* Arffa Aff. Ex. 1 ¶ 11(n); Arffa Aff. Ex. 2 ¶ 11(n).) As a result, there is simply no sustainable allegation that any of these parties should have a constructive trust imposed on its assets. Indeed it is impossible to conceive why any constructive trust should be imposed on advisors who receive fees for services they performed.

The allegation that BDCA Adviser, one of the Advisor Defendants, has been unjustly enriched or is the repository of "the unjust shifting of value from RCAP" (Compl. ¶ 137) is particularly farfetched. On November 1, 2016, BDCA

Adviser was sold by an affiliate of the ARC Parties to an affiliate of Benefit Street Partners L.L.C., which is unrelated to any of the ARC Parties. The BDCA Adviser DMA was then terminated. (*See* Arffa Aff. Ex. 12.) As a result, the alleged "value" referred to in Count III no longer resides with BDCA Adviser or its current owner, and there is no allegation that either such entity engaged in the sort of fraudulent or unconscionable conduct necessary to merit the imposition of a constructive trust.

IV.
THE CLAIMS AGAINST DEFENDANTS LOUISA QUARTO AND RCAP HOLDINGS, LLC SHOULD BE DISMISSED

In addition to the arguments set out above, two of the defendants in particular—Louisa Quarto and Holdings—should be dismissed under any circumstance, as the Trust fails to allege any actual wrongdoing by either.

A. The Claims Against Louisa Quarto Should Be Dismissed Because There Are No Allegations of Misconduct By Her

The Complaint asserts claims for breach of fiduciary duty (Count I) and aiding and abetting breach of fiduciary duty (Count II) against Ms. Quarto. Those claims should be dismissed because they are not supported by any plausible factual allegations.

The only allegations with respect to Ms. Quarto are that she: (1) served, during the relevant period, both as President of RCS and as Executive Vice President of AR Capital, and currently serves as Executive Vice President of

AR Global Investments LLC (Compl. ¶ 23); (2) was "economically dependent on, acted at the direction of, and [gave] her undivided loyalty to, the Control Defendants" (*id.*); (3) failed to disclose the allegedly off-market nature of RCS's business model (*id.* ¶ 54); (4) received a slide deck containing information about Strat Cap's business model that was omitted from the final presentation to the RCS Board (*id.* ¶ 55); and (5) knew that RCS employed more salespeople than RCS competitors did (*id.* ¶ 65).

These allegations are wholly insufficient. The first allegation—that Ms. Quarto served in dual roles—cannot support a breach of fiduciary duty claim because business people frequently serve as employees, officers and directors of different companies, both related and unrelated. There is nothing remarkable nor improper about Ms. Quarto's having done so.

The second and third allegations are conclusory and thus fail to state a claim. *See Orman*, 794 A.2d at 24 ("The shorthand shibboleth of dominated and controlled directors is insufficient." (citation & internal quotations omitted)). The fourth allegation—that Ms. Quarto received a slide deck and left portions of it out of a presentation—does not establish any wrongdoing on her part. The allegedly omitted information at issue (relating to Strat Cap's performance management services) is the same information discussed above that in fact RCAP knew and publicly disclosed. (*See supra* at 42-44.)

The fifth allegation—that Ms. Quarto supposedly knew that RCS employed more salespeople than RCS's competitors (Compl. ¶ 65)—cannot support a breach of fiduciary duty claim. Even if true, this allegation is innocuous on its face. Indeed, one would expect the president of a company to know generally the size of her staff relative to that of the company's competitors.

These are the entirety of the Trust's allegations against Ms. Quarto. She is not alleged to have been involved in any other improper transaction or alleged wrongdoing. Accordingly, there is no basis for her to remain in this case.

B. The Claims Against Holdings Should Be Dismissed Because There Are No Allegations of Misconduct By Holdings

The Trust's breach of fiduciary duty and aiding and abetting claims against Holdings likewise should be dismissed.

The Complaint's only allegations as to Holdings are that: (1) Holdings was a controlling shareholder of RCAP by virtue of its ability to exercise its B Share interests, and (2) "[t]hrough Holdings, the Control Defendants [ ] sold shares of their own stock [in RCAP] to the public . . . ." (*Id.* ¶¶ 16, 35.) These allegations do not support the conclusion that Holdings engaged in any wrongful conduct or otherwise breached any supposed duties to anyone. Absent such allegations, Holdings should be dismissed as a party.

CONCLUSION

For all of the reasons set forth above, the Trust's claims should be dismissed.

PAUL, WEISS, RIFKIND, WHARTON & GARRISON LLP

By: */s/ Stephen P. Lamb*
Stephen P. Lamb (#2053)
Meghan M. Dougherty (#4787)
500 Delaware Avenue, Suite 200
Post Office Box 32
Wilmington, Delaware 19899-0032
Telephone: (302) 655-4410

Attorneys for Defendants Nicholas S. Schorsch; Edward M. Weil, Jr.; William Kahane; Peter M. Budko; 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

OF COUNSEL:

Allan J. Arffa
Gregory F. Laufer
Jeremy A. Benjamin
PAUL, WEISS, RIFKIND, WHARTON & GARRISON LLP
1285 Avenue of the Americas
New York, New York 10019-6064
Telephone: (212) 373-3000
Facsimile: (212) 757-3990

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CERTIFICATE OF SERVICE

I hereby certify that on May 26, 2017, the foregoing was caused to be served upon the following counsel of record via File & Serve*Xpress*:

Philip Trainer, Jr., Esq.
Marie M. Degnan, Esq.
ASHBY & GEDDES
500 Delaware Avenue
P.O. Box 1150
Wilmington, DE 19899

Elizabeth A. Sloan, Esq.
BALLARD SPAHR LLP
919 N. Market Street, 11th Floor
Wilmington, DE 19801-3034

A. Thompson Bayliss, Esq.
Sarah E. Hickie, Esq.
ABRAMS & BAYLISS LLP
20 Montchanin Rd., Ste. 200
Wilmington, DE 19807

/s/ Stephen P. Lamb
Stephen P. Lamb (#2053)