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-SG

PLAINTIFF'S ANSWERING BRIEF IN OPPOSITION TO DEFENDANTS' MOTION TO DISMISS THE VERIFIED COMPLAINT

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The RCS Creditor Trust (the "Trust"), by and through its attorneys, Kramer Levin Naftalis & Frankel LLP and Ashby & Geddes, respectfully submits this Memorandum of Law in Opposition to the Motion to Dismiss the Verified Complaint (the "Motion", addressed to the "Complaint") filed by the ARC Parties[1] and joined by Defendant Brian S. Block.

PRELIMINARY STATEMENT

The Complaint sets forth, in detail that Defendants ignore or misread, a compelling story of self-interest trumping fiduciary duty. Based only on the facts already known, before discovery has even begun, Defendants' liability is clear – so clear, in fact, that their motion remains silent on several major episodes of wrongdoing causing many millions of dollars in harm to RCAP, including the cover-up of criminal accounting fraud at a related entity known as ARCP. In truth, the mislabeled submission is only a *partial* motion to dismiss.

Nicholas Schorsch and the other "Control Defendants" (*see* ¶ 1 & n.1) created an immensely profitable business launching and running multi-billion dollar non-traded investment vehicles, mostly REITs, for sale to retail investors. The business still generates lucrative annual management fees, a share of fund profits, and generous transaction fees. But raising tens of billions of dollars in

[1] Capitalized terms are defined as in the Complaint and in the ARC Parties' Memorandum of Law in Support of Motion to Dismiss ("Def. Br."). References to "¶ _" are to the Complaint.

investments in these products was time consuming and expensive. Because FINRA rules limit fees that can be charged in connection with selling such products, and most of this goes to other parties in the distribution chain, no one even *tries* to turn a profit acting solely as a wholesaler of non-traded REITs. Instead, this function is almost always performed by "captive" wholesale divisions owned by REIT sponsors, with all of the value associated with raising investments enjoyed by the same enterprise that incurs the costs of distribution. In the rare situation where wholesale operations are independent from the REIT sponsor, the entity owning the wholesaler customarily bargains for and receives a share of the more profitable advisory end of the business (colloquially, a piece of the "management economics").

The central breach of fiduciary duty at issue here is the Control Defendants' self-interested scheme to keep 100% of the fees generated by their wholly owned fund-creation and management business (known as AR Capital) while imposing the wholesaling costs on another entity (RCAP) that they controlled but in which they held only a minority interest. The Control Defendants ran RCAP as their personal piggy bank – among other things, forcing it to enter into off-market business arrangements to shift costs to RCAP while keeping the profitable aspects of the business for AR Capital; recklessly overstaffing the wholesale business to generate maximum profits for AR Capital while making it even harder for RCAP's wholesale subsidiary (known as "RCS" or "Wholesale") to stay in the black; and using hundreds of millions of dollars raised by RCAP mostly from public investors to undertake acquisitions that favored AR Capital's interests over RCAP's.

The Control Defendants' exploitation of RCAP was brazen. Although they stood on both sides of, and personally benefitted from, key transactions – and thus are not entitled to "business judgment" deference – Defendants made no attempt to ensure that disinterested RCAP directors considered and approved these self-interested transactions. Instead, they exercised unfettered control of both companies, creating – and vastly profiting from – a textbook breach of the fiduciary duty of loyalty. In one revealing episode, RCS's own President, Louise Quarto, advocated to preserve "our" share when an RCS client terminated a wholesale agreement upon disclosure of the ARCP fraud – the word "our" tellingly referring to AR Capital, which had improperly kept for itself what should have been RCAP's share of the related advisory business.

While denigrating the Complaint as implausible and far-fetched, Defendants fail even to address several compelling allegations of misconduct – including the concealment of criminal accounting fraud at ARCP, which led directly to a $60 million loss for RCAP (and indirectly inflicted even greater injury), as well as self-interested interference with attempts to recapitalize RCAP.

Beyond the substantial damages these episodes caused in their own right, they are also crucial parts of a narrative of pervasive breach of duty and lend credence and context to the entire Complaint.

Defendants also improperly (and inaccurately) allude to purported facts outside the Complaint. They falsely represent that independent investigations and RCAP's lead independent board member blessed their conflicted behavior and wrongly suggest that an entity called RCS Management (which played a ministerial role that did not supplant Defendants' fiduciary duties) and Luxor (the outside investor that suffered the largest loss as a result of Defendants' malfeasance) had material roles in the decisions challenged in the Complaint. Though irrelevant on this Motion, at the appropriate time the Trust will demonstrate that these assertions are false.

Defendants' dismissive rhetoric cannot defeat the Complaint's valid claims – particularly at the pleading stage, where all allegations must be accepted as true and all reasonable inferences drawn in Plaintiff's favor. Contrary to Defendants' strawman arguments, the Complaint does not allege irrational or illogical conduct, but accurately describes a coherent scheme that was designed to, and did, maximize the overall wealth of Mr. Schorsch and his colleagues at the expense of RCAP and its outside investors. It includes detailed factual allegations establishing the conflicted status and disloyal conduct of each individual

Defendant and appropriately names as defendants entities through which they acted and received ill-gotten profits.

None of Defendants' arguments for dismissal holds water.

First, the Complaint states a valid claim for breach of fiduciary duty based on Defendants' failure to exercise independent judgment on behalf of RCAP to negotiate, in return for providing RCS's valuable wholesaling services, for a share of the lucrative advisory business. Defendants' argument that there can be no breach of fiduciary duty because RCS's "business model" was adopted before RCAP went public ignores that (1) Defendants always owed RCAP itself a fiduciary duty to maximize its value, and (2) this duty continued once RCAP had outside stakeholders and continued to renew and enter into new wholesaling contracts for RCS on unfavorable terms.

Nor are Defendants correct in arguing that it would have violated FINRA regulations for RCAP, as a condition of permitting RCS to enter into additional wholesaling agreements, to demand a portion of the advisory work for another RCAP subsidiary. AR Capital in fact did precisely the same thing when agreeing to let RCS distribute third-party REITs – except it kept the bargained-for share of management economics for itself (through newly created AR Capital subsidiaries with no employees that subcontracted most of the actual advisory work), rather than placing it under RCAP where it rightfully belonged.

Purported "disclosure" of these abusive business terms does not excuse the breach of Defendants' fiduciary duty, because (1) disclosure is a distinct obligation that does not obviate a breach of loyalty claim, and (2) in any event, no such effective disclosure was made – all that was disclosed was RCS's fee structure, not Defendants' failure to leverage the wholesale function to generate benefits for RCAP or other breaches of duty.

Second, Defendants' argument that the intentional overstaffing of RCS's wholesale operations cannot constitute a breach of fiduciary duty fails for several reasons. The egregious overstaffing and overspending were part of a pattern of conduct by conflicted fiduciaries to burden RCAP and enrich themselves that must be considered as a whole. And whether or not that overstaffing was "corporate waste," it was reckless, imprudent, and inimical to RCAP's interests. Defendants' mantra that increasing sales must have benefitted both AR Capital *and* RCAP ignores the well-pleaded allegation that AR Capital profited from every marginal sale, while RCAP lost increasing amounts of money as it spent more to generate sales for AR Capital.

Third, the Complaint's allegations about unwise acquisitions are a valid part of the breach of fiduciary duty claim. Each challenged acquisition used money raised by RCAP from outsiders to advance AR Capital's business goals, often directly against RCAP's interests. The StratCap acquisition doubled down on the unprofitable wholesale business, adding sales volume that benefitted AR Capital without helping, and indeed harming, RCAP's bottom line. Defendants concealed from the independent directors that StratCap had, as an independent broker-dealer, negotiated precisely the type of arrangements to share in the profitable advisory business of its fund-creating counterparties that Defendants now claim would have been illegal for RCAP to seek. Defendants do not defend the logic of the SK Research acquisition, which silenced an outside critic of AR Capital's products while incurring huge costs to establish an in-house research function at RCAP to evaluate AR Capital's own products – obviously an idea doomed to fail. And the Docupace acquisition shifted another AR Capital cost center (software development) onto the shoulders of RCAP's public investors without compensating RCAP or protecting it from loss.

Fourth, the Complaint's allegations regarding proxy fraud demonstrate further breaches of duty – pressure brought by the Control Defendants on RCAP employees to act unlawfully to further AR Capital's interests in effectuating a cash-out transaction with the private equity fund Apollo. The Complaint alleges that this conduct was widespread and endorsed by the Control Defendants, who were its sole intended beneficiaries.

Fifth, the Complaint validly alleges, in the alternative, that if any of the Control Defendants lacked a fiduciary duty to RCAP at any particular time, their actions nevertheless constituted aiding and abetting the breaches of those who did have such duties. The pleading is not conclusory; it incorporates all of the allegations underlying the breach of duty claim.

Sixth, the Complaint alleges good claims for unjust enrichment and constructive trust against the Advisory Defendants – entities owned and controlled by the Control Defendants and charged with their actions and knowledge. These claims do not duplicate contract claims and properly link up RCAP's impoverishment with the Advisory Defendants' unjust enrichment through receipt of "management economics" profits that should have gone to RCAP. Disgorging these profits is crucial to remedy the breaches of duty perpetrated by Mr. Schorsch and his colleagues.

STATEMENT OF FACTS

A. The Parties

The Trust was established under RCAP's bankruptcy plan to pursue litigation claims on behalf of RCAP and its subsidiaries. ¶ 14. RCAP was a Delaware corporation created by the Control Defendants to act as a holding company for their wholesale broker-dealer and certain other businesses. ¶ 15. Defendant Holdings is a Delaware LLC owned by the Control Defendants that was RCAP's controlling shareholder. ¶ 16.

Defendant Schorsch is the Chairman, CEO, co-founder, and controlling shareholder of AR Capital. He also served as Executive Chairman of RCAP's board and CEO of American Realty Capital Partners ("ARCP") (¶ 17), a related party involved in the accounting fraud that Defendants' brief ignores. The other Control Defendants – Messrs. Weil, Kahane, Budko, and Block – each were directors and held other fiduciary roles at RCAP; held significant financial stakes in AR Capital and played other roles with various entities in the Schorsch empire; and have deep ties and loyalty to Mr. Schorsch and have been handsomely compensated for doing his bidding. ¶¶ 18-21, 28, 38. Defendant Quarto served simultaneously as President of RCS and Executive Vice President of AR Capital and at all relevant times has similarly been economically dependent on, loyal to, and acted at the direction of the Control Defendants. ¶ 23.

Defendant AR Capital, Mr. Schorsch's primary corporate vehicle, sponsors and manages non-traded investment vehicles. Defendant AR Global Investments LLC is held out as AR Capital's successor; both are referred to in the Complaint as "AR Capital." ¶ 24. The "Advisor Defendants" are shell entities set up by AR Capital to nominally perform and receive income for management services provided to AR Capital's REITS. ¶ 25.

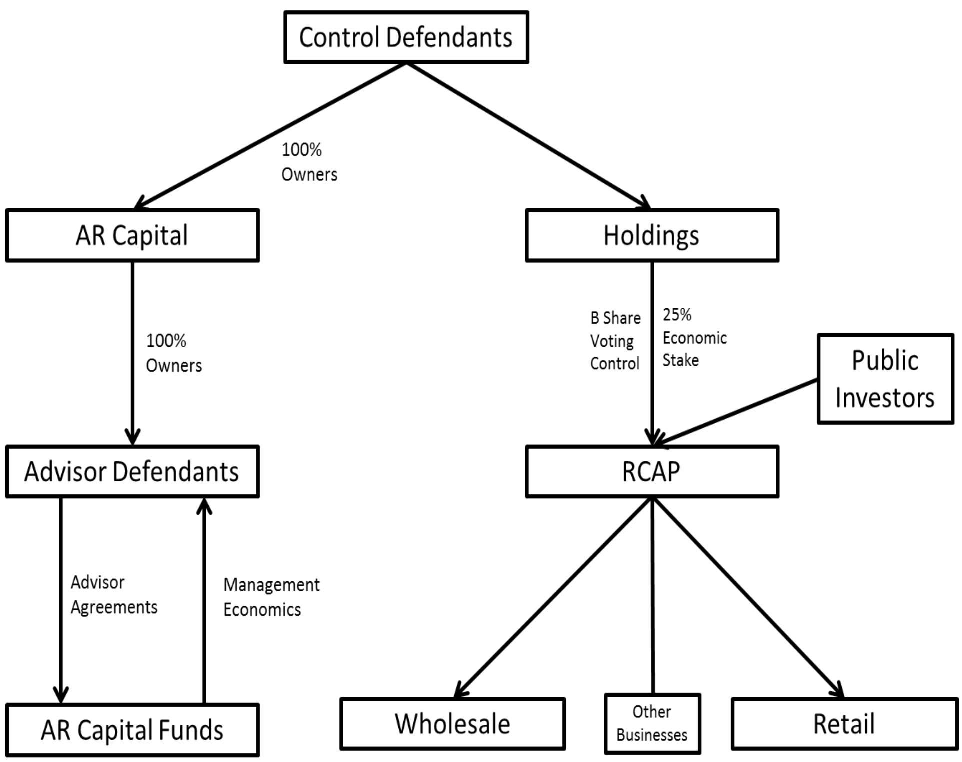
B. Schorsch Creates a Non-Traded Empire and Takes RCAP Public, Creating Potential Conflicts of Interest

Mr. Schorsch became wealthy repackaging abandoned bank branches into a REIT, which he took public and eventually left in 2006 with a huge severance package despite poor performance and investor losses. ¶ 27. He and Defendant Kahane (soon joined by the other Control Defendants) then founded AR Capital in 2007 to enter the non-traded REIT market. ¶ 28. The five AR Capital partners pooled their resources in 2008 to launch RCS, also referred to in the Complaint as "Wholesale," to distribute their products. After setbacks during the 2008 financial crisis, the Control Defendants grew AR Capital by 2012 into a leader in the non-traded REIT market. ¶ 29.

Although AR Capital was profitable, the Control Defendants developed a scheme to make it even more so by largely offloading a key cost center on third parties. In December 2012, they created RCAP as a holding company to own Wholesale, as well as smaller entities (accounting for only 3% of RCAP's revenue) performing other functions. ¶¶ 30-31. The Control Defendants then sold a stake in RCAP to public investors, setting the stage for the self-dealing addressed in the Complaint. From 2013 to 2014, RCAP raised more than $1.5 billion from public investors through a combination of public stock offerings and secured and unsecured debt. ¶¶ 33-35, 123. Most of this funding was used to acquire Cetera Financial Holdings LLC ("Cetera"), which formed the nucleus of

RCAP's retail brokerage business, the only part of RCAP that survived its bankruptcy. ¶ 34.[2]

The Control Defendants always owned 100% of AR Capital. But they repeatedly reduced their economic stake in RCAP – from over 90% to only 25% after the secondary offering in 2014 – while retaining control through Holdings, which owned the single "B" share with majority voting power at RCAP. ¶ 37. The following chart (¶ 36) provides a simplified overview of the ownership structure of AR Capital and RCAP at this juncture:



[2] While Defendants suggest that RCAP successfully diversified its business through a range of acquisitions (Def. Br.15 n.6), no acquisition outside of the retail brokerage area made a positive contribution to RCAP's performance.

The Control Defendants installed RCAP directors and managers loyal to Schorsch, rather than industry veterans with public company experience. Each of the individual defendants has at one time been an officer or director of RCAP. Mr. Schorsch himself was RCAP's Chairman before resigning after he was implicated in the ARCP accounting fraud, discussed below. Messrs. Kahane and Weil both served as RCAP's CEO. Messrs. Budko and Block were RCAP directors, and Mr. Block – a key (and now convicted) perpetrator of the ARCP fraud – was CFO. Louisa Quarto served simultaneously as President of Wholesale and Executive Vice President of AR Capital. Yet no mechanisms were put in place to assure that decisions involving the interests of both companies were made by disinterested officers and directors. ¶ 38.

There is no dispute that Mr. Schorsch and the other Control Defendants controlled both RCAP Holdings and RCAP itself. ¶ 39.[3] However,

[3] Improperly going outside the Complaint, Defendants falsely (and irrelevantly) suggest that RCS Management, which performed ministerial services for RCAP, is the proper target of this litigation. *See* Def. Br.6-7. They tellingly fail to provide the Court with the contract governing those services, which expressly does *not* supplant the fiduciary duties of RCAP's officers and directors, who retained the power and responsibility to make the decisions challenged in this lawsuit.

Equally false and irrelevant is the related suggestion that Luxor (a minority shareholder of RCAP that also was given a small interest in RCS Management) or Michael Conboy of Luxor (who served briefly, and long after most of the events at issue in this suit, as an independent director of RCAP) were "deeply entrenched in the management and business strategies of RCAP." Def. Br. 7, *see also id.* at 21. (The citation provided for this assertion, Arffa Aff. Ex. 6 at 25, says no such because they retained only a 25% *financial* stake in RCAP, 75 cents out of every dollar they caused RCAP to spend came from public investors, not their own pockets. This created a structural conflict of interest, which played out in the tension between RCAP's retail and wholesale businesses. Public investors preferred for RCAP to build on the Cetera retail brokerage network, which was profitable but not particularly beneficial to AR Capital. In contrast, AR Capital sold *all* of its product through RCS and was thus motivated to expand Wholesale regardless of profitability – and to take any other action that might enhance AR Capital's business. Although RCAP told the market that it would emphasize retail, its conflicted managers marched, disastrously, in the opposite direction. ¶¶ 40-43.

C. The Economics of the Non-Traded REIT Business Create Inherent Conflicts

The conflict of interest exploited by the Control Defendants arose directly from the economics of the non-traded REIT industry. AR Capital created investment vehicles, typically by purchasing assets such as real estate; obtaining financing; managing the fund; and ultimately selling the business, taking it public, or winding it down. This business was (and remains) immensely profitable, throwing off annual management fees typically equal to 1% of assets under

thing.) Neither Luxor nor Mr. Conboy had any involvement in, let alone the ability to block, the wrongdoing at issue here.

Significantly, these rhetorical diversions in the preliminary sections of Defendants' brief are not even mentioned in the argument proper.

management, together with hefty asset acquisition and disposition fees and various forms of profit-sharing. ¶ 44. Wholesale, in turn, had the arduous task of marketing AR Capital's products to retail broker-dealers and financial advisors. Wholesale distributed 100% of AR Capital's product, and the more product sold, the more profitable AR Capital became. ¶ 45.

Wholesale's business as a standalone operation was much less profitable. The wholesaling process is labor-intensive, and the fees that can be charged are capped by law. FINRA Rule 2310 limits total sales commissions and expenses to 10% of the investment amount, of which 7% typically goes to financial advisors to incentivize them to put their clients in these fee-heavy investments. Another 1-2% goes to the retail broker-dealer, leaving only 1-2% for the wholesaler – which must cover all expenses and pay internal commissions before realizing any profit. Thus, for every $1 billion raised, the wholesaler receives only approximately $15 million to cover its significant sales and distribution costs, while the fund sponsor receives a 20-year stream of fees worth hundreds of millions of dollars.

Wholesaling therefore is typically run as a cost center within a vertically integrated organization (as RCS was prior to its spinoff to RCAP). In the rare case where the wholesale operation is separate, the company owning it negotiates for a share of the profitable advisory business generated by the investments raised – and has the leverage to do so in light of the high value of wholesale services. ¶¶ 46-47. The key breach of fiduciary duty challenged in this suit is Defendants' failure to negotiate fair deals between AR Capital and RCAP – forcing RCS to take on wholesaling obligations to benefit AR Capital without the customary ancillary terms necessary to justify RCAP's investment in that business.

Defendants acknowledge that this account of the non-traded REIT fee structure is accurate (Def. Br. 11-12), but challenge the characterization of the wholesale function as "inherently unprofitable" based on commentary suggesting that the *total* 10% allowable commission is "excessive." *Id.* at 12 (citation omitted). But whether or not the total is excessive, 8-9% goes to parties other than the wholesale broker-dealer, leaving little to run the labor-intensive wholesale operation. There is no sense to Defendants' repeated assertion that the wholesale business "surely" must be profitable at high volumes. *Id.* at 13, 33. As the Complaint sets forth in detail, Wholesale was at best modestly profitable even before the Control Defendants reduced their economic stake in RCAP and began actively to exploit it; thereafter, it lost significant amounts of money even at high volumes. *See* ¶¶ 59-64.

Defendants' contention that negotiating for a share of the more profitable advisory business violates FINRA Rule 2310 (Def. Br. 12-13, 28-30) is wrong. That rule applies only to RCS itself, the entity conducting the wholesale business; it would not prevent *RCAP*, which owned and controlled RCS, from providing RCS's valuable services only if it was given a share of the profitable related advisory business, to be performed by a separate subsidiary.

The Complaint sets forth several examples of this type of arrangement that satisfied regulatory scrutiny. *First*, StratCap, an independent wholesaler acquired by RCAP in 2014, used precisely this approach with all of its counterparties. Whenever its wholesale broker-dealer subsidiary entered into an agreement to market a non-traded REIT, StratCap 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. ¶ 49. *Second*, as Defendants admit (Def. Br. 14), when Phillips Edison launched a grocery-related REIT called PECO in 2010, AR Capital agreed to have Wholesale (then a wholly owned subsidiary) serve as wholesale dealer-manager only when *another* newly created AR Capital subsidiary was given an advisory role for which it was paid 22.5% of the management economics – a fair market deal strikingly similar to what StratCap customarily negotiated. ¶ 50.

Defendants oddly maintain that this "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." Def. Br. 14. But RCS did not itself benefit by increasing the volume of its labor-intensive wholesale work; the real profit, which AR Capital kept for itself, was in the advisory work. And when Phillips Edison launched a new fund, PECO II, in 2013, AR Capital once again agreed to provide the wholesale services of RCS – now part of RCAP – while keeping the same lucrative slice of the advisory business for itself, creating yet another *AR Capital* subsidiary, which could just as easily have been part of RCAP. ¶ 51.

Defendants' disloyalty to RCAP was underscored when, after the ARCP accounting fraud was disclosed, the PECO funds moved to terminate all association with any entity associated with Mr. Schorsch. Remarkably, negotiations were conducted on AR Capital's behalf by Wholesale attorneys and led by Wholesale President Louisa Quarto. Instead of representing Wholesale's interests, they fought for the *AR Capital* entity to continue to receive what Ms. Quarto called "our" share of the management economics in the restructured deal. ¶ 52. This violation of the duty of loyalty – with all decisions made on behalf of RCAP by conflicted fiduciaries – was business as usual for Mr. Schorsch and his colleagues. ¶ 38.

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

The Control Defendants breached their fiduciary duty to RCAP from its inception when they caused RCAP to receive the Wholesale business and assume existing dealer-manager agreements that obligated Wholesale to distribute

AR Capital product without receiving any share of the associated advisory work. RCAP's initial 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, even though the Control Defendants and Defendant Quarto, whom Schorsch had installed as President of Wholesale, knew the arrangements were off-market. While independent directors were added to the RCAP Board of Directors in early 2013 in preparation for taking the company public, they were never permitted to review or approve existing and new business arrangements (including periodic renewals and amendments of existing contracts) between RCAP and other Schorsch entities. ¶ 54.

For example, in October 2013, when the Control Defendants were contemplating the StratCap acquisition, a Wholesale employee e-mailed an overview of StratCap's business to Mr. Weil and Ms. Quarto. This slide deck revealed, as discussed above, that StratCap always received a 20% to 25% share of the management economics in addition to the limited wholesale fee percentage. This information was crucial to understanding StratCap's business model and the historical and projected earnings cited to justify the generous purchase price. It nevertheless was excluded from the single slide deck provided to the RCAP Board to obtain its written consent to the acquisition – no doubt because it would have revealed the off-market nature of RCAP's existing deals with AR Capital. ¶ 55.

Lead RCAP independent director Mark Auerbach has testified that it was not until the StratCap acquisition was completed, and the Board began receiving information about StratCap's revenue stream, that the independent directors became aware that RCAP's deals with AR Capital were off-market. When he raised this with the Control Defendants, they responded with nothing but a smile. ¶ 56.

The independent directors were powerless to remedy the abuse of RCAP in light of the Control Defendants' total domination – 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 subordinates. The arrangements were never presented to the RCAP Board for approval. Each time the Control Defendants caused RCAP to assume, enter into, or renew these off-market and ultimately disastrous agreements was a distinct breach of their fiduciary duties. ¶ 57.

E. The Control Defendants Force RCAP to Overstaff Wholesale to Sell More AR Capital Product

The Control Defendants further exploited RCAP by causing Wholesale to maintain irrational and unsustainable staffing levels – refusing to "right size" the business even after it slid downhill following disclosure of the ARCP fraud. The reason was simple: The Control Defendants received 100% of the benefits, but paid only 25% of the costs, from any increase in AR Capital sales, while 75% of the costs were imposed on RCAP's public shareholders.

Based on unverified public numbers, Wholesale appears to have been modestly profitable prior to RCAP's IPO, at least when it raised $1 billion or more in a given quarter – a profit structure that may have made sense when RCAP was a wholly owned cost center within a larger REIT enterprise. ¶¶ 59-60. After the Control Defendants diluted their stake in RCAP, Wholesale bled cash. ¶ 61. The difference was the Control Defendants' built-in incentive, after minimizing their economic stake in RCAP, to use other peoples' money to generate additional sales regardless of whether it made economic sense for RCAP.

Thus, Wholesale bulked up its staffing to 190-200 employees by 2013 and maintained that level, as well as lavish spending on marketing events, despite marginal results and even after the business declined dramatically in the wake of the ARCP fraud disclosure. RCAP's conflicted managers were aware of the problem – indeed, Cetera specifically warned RCAP CEO Weil that Wholesale's mounting losses were threatening RCAP's solvency – but they did nothing to rationalize staffing levels until Wholesale was shutting down at the end of 2015, instead focusing on driving sales. This was rational conduct for executives loyal to AR Capital, but irrational for fiduciaries focused on RCAP's success. ¶¶ 64-67.

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

The Motion is oddly silent about a central event described in detail in the Complaint: Mr. Schorsch causing RCAP to enter into an ill-fated deal in October 2014 to purchase a related-party business from ARCP for $700 million, while concealing from RCAP's independent directors that ARCP was in the midst of an accounting fraud investigation that would soon devastate all Schorsch-related businesses. That announcement and its aftermath sent shock waves that wrecked the market for all AR Capital products and forced RCAP to pay $60 million to ARCP to extricate itself from the disastrous transaction. RCAP never recovered from the harm inflicted by this scandal. ¶ 68.

In the fall of 2014, Mr. 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, Mr. Schorsch was the CEO and Chairman of ARCP and Chairman of RCAP's Board of Directors –

squarely on both sides of the transaction. ¶ 69. The $700 million-plus deal would have served Mr. Schorsch's interests by expanding RCAP's wholesale capacity (useless to RCAP) and preventing Cole Capital (which ARCP investors were clamoring to divest) from being sold to a competitor. ¶¶ 70-72.

The Control Defendants were able to engage in this self-dealing by flouting corporate governance standards. Though it was a related party transaction, there was no attempt to create a special committee of non-insider directors with independent advisors to evaluate the proposal. Instead, law firms with long ties to Schorsch businesses represented both sides of the deal. While Mr. Schorsch nominally recused himself, he continued to sit on the RCAP Board and call the shots through the other Control Defendants. ¶ 73.

Still worse, when the RCAP/Cole Capital agreement was signed on September 30, 2014, Mr. Schorsch and other Control Defendants knew that the seller, ARCP, was in the midst of an internal investigation resulting from intentional accounting errors. On October 29, 2014, ARCP publicly disclosed that based on information learned *on September 7, 2014*, its Audit Committee had hired Ernst & Young to investigate, with preliminary findings indicating that ARCP's recently filed financial statements "should no longer be relied upon." ¶ 74.

The disclosed misstatements consisted of an intentional inflation of ARCP's adjusted funds from operations ("AFFO"), a crucial metric for REITs.

The misstatement of AFFO prevented investors from understanding ARCP's faltering financial performance, in turn permitting the Control Defendants to continue to access capital markets and reap hundreds of millions of dollars in fees, commissions, and other compensation. ¶¶ 75-76.

The investigation revealed 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 its former Chief Accounting Officer, Lisa P. McAlister, had "key roles" in creating the misleading financial statements. Mr. Block and Ms. McAlister were both forced to resign, and both were ultimately indicted. Ms. McAlister has pled guilty and cooperated with federal prosecutors. ¶ 77.[4]

The Trust expects to demonstrate at trial that Mr. Schorsch and other Control Defendants encouraged and helped conceal the intentional accounting errors. In any event, Defendants were clearly aware of the internal investigation but did not disclose it to RCAP before committing it to the Cole Capital acquisition – breaching the most fundamental fiduciary duties owed to RCAP by its own officers and directors, as well as RCAP's own Code of Business Conduct and Ethics, which provides that employees, officers and directors learning of any illegal or unethical conduct "have a duty to report it immediately." ¶¶ 78-80.

[4] Though outside the Complaint (because it happened only recently) and therefore not relied on for this Motion, Mr. Block was tried in June 2017; the jury convicted on all counts on June 30 after less than a day of deliberation.

Disclosure of the ARCP fraud in October 2014 devastated all Schorsch-related businesses and launched RCAP on a downward spiral towards bankruptcy. On the day of the disclosure, RCAP's stock declined by 14% – and kept declining, closing down 17% for the week. Mr. Schorsch stepped down as ARCP's Chair in mid-December and resigned as RCAP Chair two weeks later. ¶ 81.

With the matter finally in the hands of an independent Board committee, RCAP determined that it would be imprudent to proceed with the transaction. Unfortunately, at Mr. Schorsch's direction the acquisition agreement did not include standard "material adverse event" provisions, so RCAP had to base its termination on asserted breaches of representations and warranties by ARCP, which ARCP contested in this Court. Following investigation and on advice of counsel, RCAP agreed in December 2014 to pay ARCP $60 million to unwind the transaction and resolve the litigation – a dead loss that would never have been incurred if non-conflicted directors had been informed of ARCP's internal investigation. ¶¶ 82-85.

As fall-out from the fraud disclosure continued, dozens of broker-dealer firms suspended selling agreements with Wholesale. As a result, RCAP's wholesale results declined dramatically beginning in the fourth quarter of 2014, racking up tens of millions of dollars in losses before the business was ultimately dissolved on the eve of bankruptcy one year later, and its stock price continued to fall correspondingly. All of these impacts were a foreseeable result of the ARCP fraud and cover-up. ¶¶ 86-87.

Defendants' brief mentions none of this – tacitly conceding the facial validity of at least the $60 million claim, while ignoring key events that complete the picture of the Control Defendants' misconduct and abuse of RCAP.

G. The Control Defendants Cause RCAP to Pursue Imprudent Acquisitions to Serve AR Capital's Competitive Goals

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

StratCap: RCAP agreed in May 2014 to purchase StratCap, a wholesale distributor of non-traded products, an expansion of the very line of business – wholesale – that RCAP was telling investors it was deemphasizing. But the transaction served the Control Defendants' interests by eliminating a competitor and providing AR Capital with long-coveted access to national, full-service broker-dealers, known colloquially as "wire houses." After trying for years, Mr. Schorsch finally convinced StratCap's owners to sell by overpaying from the pocketbook of RCAP's public stakeholders. ¶¶ 90-91.

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 one slide deck containing a single-page "valuation analysis." As noted above, the Board was told neither that StratCap routinely bargained for a percentage of its clients' management economics (the basis for its past and projected future profitability) nor that the Control Defendants planned instead to require StratCap to sell AR Capital products on the same non-market terms they were already imposing on Wholesale. ¶ 92.

Less than two months after the StratCap transaction closed, the ARCP fraud disclosure – and the resulting widespread embargo on everything remotely touched by Mr. Schorsch – effectively destroyed even StratCap's existing business of distributing non-AR Capital products. The StratCap acquisition was a disaster, and RCAP sold it back to the prior owners for a fraction of the purchase price in barely a year. ¶¶ 93-94.

SK Research: The acquisition (or creation) of SK Research similarly served only the interests of the Control Defendants, to defang a critic of AR Capital products, without any rational purpose for RCAP. 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, functioning much like rating agencies and equity analysts do with respect to publicly traded investments. As an independent due diligence firm, Snyder Kearney LLC had been a nuisance to the Control Defendants, frequently identifying problems with AR Capital products. To eliminate this independent watchdog, on March 10, 2014, Mr. Schorsch had RCAP acquire the firm's assets and hire its employees for a payment of $10,092,000 to the partners. This dissolved the law firm and created an in-house RCAP research arm called SK Research. ¶¶ 95-97.

The deal was approved solely by the Control Defendants who comprised the Executive Committee of RCAP's Board – Defendants Schorsch, Kahane, Weil, Budko, and Block – without any presentation to the full Board, let alone consideration or approval by independent directors. ¶ 98.

The Control Defendants knew or should have known that the Schorsch-captive SK Research would never be taken seriously by the investment community as an independent and objective source of research. For this and other reasons detailed in the Complaint, SK Research was a predictable economic disaster for RCAP. On January 15, 2016, RCAP sold substantially all of SK Research's assets back to the original partners for approximately $1 million, net of adjustments, reflecting a huge loss. ¶¶ 99-101.

Docupace Technologies: RCAP's acquisition of a majority interest in Docupace Technologies ("Docupace"), a small company specializing in back-office software for broker-dealers, similarly served only AR Capital's interests. AR Capital wanted to develop software to make it easier for 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. ¶ 102.

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 conflicted Executive Committee, which committed to the transaction two months later with no review or approval by disinterested fiduciaries, brushing aside major issues identified by outside counsel. As a result, RCAP significantly overpaid for Docupace based on unsupported revenue projections that never panned out. But the acquisition served AR Capital's purpose – assuring access to software that AR Capital, but not RCAP, needed. ¶¶ 103-06.

The irrationality of 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 engaged in digital storage of customer data should operate independently of any broker-dealer or registered investment advisor, so that software would not be configured to unduly favor any investment product.

Concern that Docupace's software would push AR Capital offerings led current and potential customers to seek solutions elsewhere and hampered Docupace's growth and profitability. ¶ 107.

In addition to the inflated purchase price, 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). RCAP ultimately sold its majority stake back to Docupace's management for a fraction of what it had paid. ¶ 108.

H. The Control Defendants Block RCAP From Pursuing Independent Restructuring Alternatives and Engage in Proxy Fraud to Facilitate Their Hoped For Apollo Cash-Out

Defendants largely ignore another episode that reflects the Control Defendants' disregard of their fiduciary duties. Throughout 2015, Mr. Schorsch's empire was still reeling from the effects of the ARCP fraud disclosure, which compounded the effects of AR Capital's exploitation of RCAP. In April 2015, at the urging of lead independent director Mark Auerbach, a Special Committee of independent RCAP directors was formed, engaged professionals, and solicited third-party recapitalization proposals. ¶ 109.

Meanwhile, Mr. Schorsch was trying to sell a majority stake in AR Capital to Apollo, the prominent private equity fund, to form a new and rebranded business in an attempt to cleanse the ongoing taint of the accounting fraud. Because Apollo wanted RCAP to distribute offerings from that new enterprise, Mr. Schorsch told the Special Committee that he would use the controlling B share to block any transaction for RCAP other than one he would negotiate with Apollo. When the Special Committee nonetheless developed a promising proposal in June 2015, better on its face than Apollo's offer, Mr. Schorsch ordered "pencils down" on anything other than an Apollo deal. ¶¶ 110-12.

In August 2015, Apollo reached agreement to buy Wholesale for $20 million and simultaneously purchase 60% of AR Capital for an amount that, with earn-outs, could total nearly $900 million – illustrating the huge value of the management economics generated by the investments that Wholesale raised. ¶ 113. For reasons that remain unclear, on November 8, 2015, Apollo and AR Capital terminated that deal and RCAP announced a new agreement for Apollo to purchase Wholesale, weakened by AR Capital's continuing domination and abuse, for only $6 million, subject to certain price adjustments. But worse was still to come. ¶ 114.

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 Mr. Schorsch. To obtain necessary shareholder approval for these changes, AR Capital hired a traditional proxy solicitation firm, but also ordered Wholesale's sales representatives to pursue the necessary shareholder consents. The Control Defendants and those they directed placed extraordinary pressure on Wholesale employees to deliver the required proxies – which were for the sole benefit of AR Capital and Apollo, not RCAP. Employees later admitted to counsel and regulators that they were given no proxy solicitation training or even a script to use in calling investors, only intense pressure to get results. ¶¶ 115-17.

On June 11, 2015, the Massachusetts Securities Division ("MSD") issued a subpoena for documents related to proxy solicitation conducted out of RCS's Boston office. The subpoena was based on allegations from a whistleblower who had raised concerns about unethical behavior involving proxy solicitations by his coworkers, but was told by a supervisor 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 had an outside law firm conduct an internal investigation, which quickly revealed a pervasive pattern of improper conduct. ¶ 118.

On November 12, 2015, the MSD filed an administrative complaint to suspend Wholesale's broker-dealer license based on proxy fraud by its employees.

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 examples of Wholesale employees impersonating shareholders, in one case even using a "contrived accent." ¶ 120.

RCAP's outside counsel uncovered many additional instances of serious misconduct during the summer and fall of 2015, all related to proxy efforts for the benefit of AR Capital. The SEC and FINRA also sent RCAP inquiry letters in November and December 2015 related to allegations of proxy fraud. If RCAP had not already been winding down Wholesale to stem its ongoing losses and in response to the MSD investigation, and had RCAP not filed for bankruptcy shortly thereafter, the SEC and FINRA likely would have pursued their own damaging investigations. ¶ 121.

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 Apollo transaction was terminated. In December 2015, RCS entered into a consent order essentially stipulating to the accuracy of the complaint, paying a $3 million fine, and agreeing to permanently discontinue wholesale operations in Massachusetts. ¶ 122.

I. The Consequences of the Control Defendants' Breaches of Duty

These facts describe a regrettable course of conduct through which Defendants squandered hundreds of millions of dollars – mostly of other people's money. 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 (not three and a half, as Defendants incorrectly claim, *see* Def. Br. 20), RCAP was forced to enter bankruptcy. SK Research, Docupace, and StratCap were sold back to their original owners for a fraction of what the Control Defendants had RCAP pay for them. Wholesale was shuttered completely. Stakes in the reorganized retail broker-dealer, the only valuable business remaining, were sufficient to satisfy RCAP's first lien claims and a small fraction of the second lien claims. Equity was wiped out. RCAP's unsecured creditors stand to recover nothing beyond the proceeds of this and other litigation.

Meanwhile, Defendants 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 annual fees. While disclosure of the ARCP fraud destroyed Schorsch's ability to create new funds, the existing ones continue to generate hundreds of millions of dollars in fees for the newly dubbed AR Global – a hefty annuity that Defendants keep all for themselves. As demonstrated below, the Complaint properly calls Defendants to account for this inequitable state of affairs.

ARGUMENT

As Defendants concede (Def Br. 23-24), the Complaint cannot be dismissed under Ct. Ch. R. 12(b)(6) unless Plaintiff could not recover in "any reasonably conceivable set of circumstances." *Central Mort. Co. v. Morgan Stanley Mort. Capital Holdings LLC*, 27 A.3d 531, 535 (Del. 2011). This "minimal" pleading standard reflects Delaware's rejection of the higher "plausibility" standard of *Bell Atlantic Corp. v. Twombly*, 550 U.S. 544, 556 (2007). Under this "conceivability" standard, a court should "(1) accept all well pleaded factual allegations as true, (2) accept even vague allegations as 'well-pleaded' if they give the opposing party notice of the claim, [and] (3) draw all reasonable inferences in favor of the non-moving party." *Central Mort. Co.*, 27 A.3d at 535.

This "plaintiff-friendly" pleading standard is applied in breach of fiduciary duty cases, which do not require the particularized pleading imposed by Ct. Ch. R. 23.1. *In re Am. Int'l Grp., Inc.*, 965 A.2d 763, 795 (Del. Ch. 2009). The question is "whether the Complaint as a whole supports a reasonable inference that [defendants] breached their fiduciary duties." *Id*. The Court rejected the efforts of particular defendants, prior to "full discovery," to "attempt to focus on each scheme individually" and on "the comparative absence of fact pleading about the specific involvement" of each defendant. *Id*. Under this "Complaint as a whole" standard, the Court should consider the entire story told in the Complaint – including the portions Defendants artfully ignore – which demonstrates that it is far more than "conceivable" that Plaintiffs will prove their claims.

I.
COUNT I OF THE COMPLAINT ALLEGES VALID CLAIMS FOR BREACH OF FIDUCIARY DUTY

It is axiomatic that each of the individual Defendants, as officers, directors, and controlling shareholders, owed RCAP fiduciary duties of loyalty and care – an obligation to put the interests of RCAP and its shareholders ahead of their own at all times. *See Gantler v. Stephens*, 965 A.2d 695, 709 (Del. 2009) (officers, like directors, owe fiduciary duty to corporation); *Harris v. Carter*, 582 A.2d 222, 234 (Del. Ch. 1990) (shareholder exercising control over corporation assumes fiduciary duties).

Because each individual Defendant wore at least two hats, serving as AR Capital's fiduciary as well as RCAP's, they each had a classic "dual loyalty" conflict of interest as to dealings between RCAP and AR Capital. *See Weinberger v. UOP, Inc.*, 457 A.2d 701, 710 (Del. 1983). A director is also "interested" when he or she receives benefits from a transaction "not equally shared by the stockholders," *Rales v. Blasband*, 634 A.2d 927, 936 (Del. 1993), or bases a decision on "extraneous considerations or influences" rather than the merits of the decision, *Aronson v. Lewis*, 473 A.2d 805, 816 (Del. 1984), *overruled on other grounds*, *Brehm v. Eisner*, 746 A.2d 244 (Del. 2000). It is necessary only to raise a "reasonable doubt" as to whether a fiduciary "can be expected to act independently." *Rales*, 634 A.2d at 937. Allegations that directors are dominated and controlled may be supported by a variety of facts suggesting they are "beholden" to others, such as receipt of consulting fees, expectation of continued employment, and other forms of remuneration. *See Friedman v. Beningson*, No. CIV. A. 12232, 1995 WL 716762, at * 4-5 (Del. Ch. Dec. 4, 1995).

Here, the Complaint details the longstanding involvement of the individual Defendants in the Schorsch empire, their deep loyalty and long track record of acting at his bidding, and their financial interdependency. *See* ¶¶ 17-23, 27-30, 38-39. Each of them is "interested" regarding matters affecting Mr. Schorsch and AR Capital for this additional reason. Holdings is properly included as a defendant because it was the instrumentality through which the Control Defendants exercised dominion over RCAP. *See In re Ezcorp Inc. Consulting Agreement Derivative Litig.*, No. CV 9962-VCL, 2016 WL 301245, at **10-11, 31 (Del. Ch. Jan. 25, 2016) ("entity through which the ultimate controller exercises control" may be sued for both breach of fiduciary duty and aiding and abetting).

"Interested" fiduciaries lose the customary protection of the business judgment rule and assume the burden of demonstrating the "entire fairness" of the challenged transactions – both as to price and process. *See Weinberger*, 457 A.2d at 711. Defendants note the inclusion of independent directors on RCAP's board (Def. Br. 18), but nowhere assert that the challenged transactions actually were ratified by a majority of disinterested directors. To the contrary, the Complaint contains well-pleaded allegations that all relevant decisions were made or directed by the Control Defendants. *See* ¶¶ 38-39, 49-57, 62, 65-67, 69, 71-73, 85, 92, 98, 103, 110, 112. In such circumstances, the burden remains squarely on Defendants to prove the entire fairness of the challenged transactions. *See Weinberger*, 457 A.2d at 710 (burden to prove "entire fairness" where no attempt made to structure arm's length transaction and interested directors "did not totally abstain").

The facts summarized above detail a classic breach of fiduciary duty in terms not just "conceivable" but compelling. Defendants offer no coherent defense of their conduct, much less one that must be accepted on a motion to dismiss. Indeed, as noted, Defendants have made only a *partial* motion to dismiss, implicitly conceding the validity of the breach of fiduciary duty claims based on the ARCP fraud, the Cole Capital transaction, and Defendants' interference with non-Apollo recapitalization options. Defendants' silence is not surprising, particularly with respect to the stark breach of duty in concealing the ARCP fraud.

See Ryan v. Gifford, 935 A.2d 258, 271-72 (Del. Ch. 2007) (fiduciary duty breached where director engaged in deceptive conduct to conceal backdating practice he knew of or participated in).

Defendants' arguments for dismissal are predicated on strawman assertions and distortion of the Complaint's allegations. For example, Defendants' overarching argument that the Complaint is "patently implausible" (Def. Br. 33) and "nonsensical" (*id*. at 42) because it supposedly accuses Defendants of being "irrational" and acting "contrary to their self- interest" in not maximizing the value of RCAP (*id*. at 36) ignores well-pleaded allegations regarding how the Control Defendants structured the relationship between RCAP and AR Capital to maximize their profits. The Complaint does not allege that Defendants *hoped* that RCAP would fail; it merely describes the undeniable structural conflict of interest in which the Control Defendants bore only 25% of the burden, while reaping 100% of the profits flowing to AR Capital, under transactions affecting both companies. The Control Defendants would have been perfectly happy if RCAP broke even or stayed in business while losing money, in view of the massive profits it helped generate for AR Capital; the public shareholders, obviously, would not have been. Even when it became obvious that Wholesale's business was collapsing, Defendants took the rational action *for AR Capital;* they threw good RCAP money after bad to generate some final marginal sales for AR Capital.

As explained below, none of Defendants' more specific arguments for dismissal of the breach of fiduciary duty claim has any merit.

A. **The Fiduciary Duty Claim Is Not Barred Because the So-Called "Business Model" Was Adopted Before RCAP Went Public**

Defendants cite *Anadarko Petroleum Corp. v. Panhandle E. Corp.*, 545 A.2d 1171 (Del. 1988), for the proposition that AR Capital, as a parent company, owed no fiduciary duty to the future public shareholders of RCAP prior to its IPO. From this, Defendants argue that the "business model" of imposing non-market terms on RCAP and its subsidiaries somehow became immune from challenge. Def. Br. 26-27. This argument fails for two principal reasons.

First, under Delaware corporate law, the officers and directors of a subsidiary owe fiduciary duties to the *enterprise*, not merely to its shareholders. *See N. Am. Catholic Educ. Programming Found., Inc. v. Gheewalla*, 930 A.2d 92, 101 (Del. 2007). Thus, among other things, "the creditors of an insolvent corporation have standing to maintain derivative claims against directors on behalf of the corporation for breaches of fiduciary duties." *Id.* *Anadarko* nowhere mentions the duty owed directly to the corporation itself by its officers and directors, and subsequent cases have read it narrowly to avoid any suggestion that "the directors of an insolvent subsidiary can, with impunity, permit it to be plundered for the benefit of its parent corporation." *In re Scott Acquisition Corp.*, 344 B.R. 283, 288 (Bankr. D. Del 2006).[5]

When RCAP accepted RCS with its marginally profitable wholesale business, it gained the leverage to insist on reasonable market terms, including a share in the management economics related to capital raised by RCS. It was a breach of fiduciary duty – a continuing wrong that ran through RCAP's bankruptcy filing − for RCAP's interested directors and officers to fail to maximize the value of that leverage and instead to direct such opportunities to AR Capital, regardless of whether any party could sue over this breach at the time. After Defendants ran RCAP into insolvency, the Trust gained standing to pursue that breach of duty claim. Defendants' assertion that these actions "predate the moment at which the Individual ARC Defendants and Holdings assumed any fiduciary duties to RCAP" (Def. Br. 27) flouts bedrock principles of Delaware corporate law.

Second, even assuming *arguendo* that Defendants had no duty to maximize the value of RCAP when it was a wholly owned subsidiary, everything changed once the company had public shareholders. At that point, RCAP's officers and directors unquestionably had a fiduciary duty – directly to the entity

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[5] Defendants cite only one other case on this point, *Trenwick America Litig. Trust v. Ernst & Young L.L.P.*, 906 A.2d 168 (Del. Ch. 2006), *aff'd*, 931 A.2d 438 (Del. 2007) (Table), which holds only that a parent corporation does not owe a fiduciary duty to its subsidiary. Like *Anadarko*, this case simply does not address the duties owed by officers and directors of the subsidiary to the entity itself.

and, through it, to those shareholders – to seek to enforce arm's-length, commercially reasonable terms in its dealings with AR Capital. Of course, the conflicted Control Defendants did precisely the opposite: They continued to exploit RCAP for AR Capital's benefit. Every time the Control Defendants caused RCAP to abdicate its commercial leverage and agree to extend, renew, or add a new contract on non-market terms, they undeniably breached their fiduciary duties.

That the basic "business model," as Defendants call it (Def. Br. 27) had been adopted before the IPO did not immunize it from scrutiny thereafter. Fiduciary duties are dynamic and include the obligation to respond to changing facts and circumstances. *See, e.g.*, *Omnicare, Inc. v. NCS Healthcare, Inc.*, 818 A.2d 914, 938-39 (Del. 2003) (directors have continuing obligation to discharge their fiduciary responsibilities, as future circumstances develop, "on a continuing basis"); *Cal. Pub. Employees' Ret. Sys. v. Coulter*, No. CIV. A. 19191, 2005 WL 1074354, at *4 (Del. Ch. Apr. 21, 2005) (board must retain power to redeem poison pill "to fulfill its fiduciary duties as circumstances change").

After the IPO, the officers and directors had a duty to consider anew whether RCAP's old way of doing business (taking on unprofitable wholesaling obligations without using the leverage thus created to demand a piece of the more profitable advisory business) comported with their new or expanded duties. And they had a duty to do so every time RCS entered into a new wholesale dealer-manager agreement with AR Capital, or renewed an existing agreement, or merely allowed an existing agreement to continue in the face of a right to terminate.

Precisely this conclusion was reached in *Teachers Ret. Sys. of La. v. Aidinoff*, 900 A.2d 654 (Del. Ch. 2006), an instructively analogous case involving putatively unfair contracts between AIG and two companies, Starr and SICO, that were privately held by AIG officers and directors led by Maurice Greenberg. Defendants argued that derivative claims for breach of the fiduciary duty of loyalty were time-barred because the contracts in question had first been entered into many years ago, in the 1970s, and all future harm should be "considered as a natural consequence flowing from the original decision by the defendant-fiduciaries to obligate the corporation to the contract." *Id*. at 666. Then-Vice Chancellor Strine rejected this argument, noting that each challenged contract included an annual right to terminate without notice or cause. Each time this right was *not* exercised represented a new breach of duty. "To hold otherwise would be to create a rule of law protecting inertial stupidity and perfidy." *Id.*

B. The Breach of Fiduciary Duty Claim is Not Barred by FINRA Regulations

Defendants next argue that their imposition of non-market terms on RCAP cannot constitute a breach of fiduciary duty because the so-called "business model" was supposedly "mandated by law" as a result of FINRA regulations limiting *RCS*'s compensation for marketing non-traded REITs to 10% of the gross offering proceeds. Def. Br. 28-29. But the fiduciary duty claim is asserted on behalf of *RCAP*, not RCS, based on the Control Defendants' failure to maximize the value of RCAP's overall business. FINRA restricts only the compensation that *RCS* as wholesaler could earn for wholesale distribution. Nothing in the regulations prevented *RCAP*, as its parent company, from negotiating for a share of the advisory business to be performed by separate subsidiaries. The 10% cap does not apply to such arrangements.

Defendants ignore the Complaint's detailed account of how precisely the same model was employed by StratCap (when it was independent) and by *AR Capital itself* in connection with the Phillips Edison-owned PECO funds. Defendants attempt to distinguish both examples by noting that affiliated entities in these cases actually performed management services, while RCS engaged only in wholesaling. Def. Br. 31-32. But the Complaint does not allege that *RCS* should have received additional income; another RCAP entity could easily have been created, just as StratCap and AR Capital did every time they obtained new advisory work.

Defendants note that Phillips Edison had "special expertise in the grocery industry" as the reason it performed advisory work for the PECO REIT. Def. Br. 31. This misses the point: the relevant comparison, made in the Complaint, is to the advisory role extracted by *AR Capital* as a price for providing

RCS's wholesale services, in which ARC Advisor got 22.5% of the "promote" while delegating most of the actual advisory work to the PECO Sub. ¶ 50. Defendants do not suggest that this arrangement was illegal, and indeed the FINRA regulations themselves include guidance on when it is permissible for affiliates of an underwriter or broker-dealer to receive compensation beyond the 10% cap. *See* FINRA Rule 2310(b)(4)(F) (listing factors governing determination "whether compensation paid to underwriters, broker-dealers, or affiliates thereof is in connection with or related to a public offering"). Defendants do not explain why this regulation permitted AR Capital to demand a share of the advisory work from Philips Edison and assigned it to newly created ARC Advisor, but somehow barred the same contract from being assigned to an equivalent RCAP subsidiary.[6]

In a final twist to this confused argument, Defendants suggest that the StratCap acquisition showed the Control Defendants' willingness to adopt the "model of acting both as a REIT wholesaler and advisor" – rendering the Complaint somehow contradictory and illogical. Def Br. 32. Leaving aside that

[6] As explained above (at 16-17), when the PECO funds severed their relationship with RCAP in light of the ARCP fraud, RCS President Louise Quarto pressed for *AR Capital* rather than RCAP to retain what she called "our" share of the management economics. *See* ¶ 52. This disloyal conduct – omitted from Defendants' purported recitation of the "only allegations with respect to Ms. Quarto" (Def. Br. 58-59) – is not the only valid allegation against her; she is also implicated in acquiescing in the off-market business model; misleading the Board regarding StratCap; and overstaffing RCS. *See* ¶¶ 54-55, 65.

this argument comes one page after Defendants describe such an arrangement as inherently illegal, it also ignores allegations that the Control Defendants *hid* this aspect of the StratCap business from the independent directors, had no intention of sharing management economics for AR Capital funds, and intended to force StratCap to do business on the unfair terms already imposed on RCS. ¶ 92.

C. The Breach of Fiduciary Duty Claim is Not Barred by the Supposed "Disclosure" of the Non-Market Terms Imposed on RCAP

Defendants' argument that supposed "disclosure" (Def. Br. 32) of the non-market terms under which they forced RCAP to operate somehow obviates the breach of fiduciary duty claim is both legally and factually groundless.

As a matter of law, even effective disclosure of their fiduciary breaches would not excuse Defendants from liability. The duty of loyalty includes a duty of disclosure, but mere disclosure does not obviate entire fairness review absent approval by disinterested directors or shareholder ratification. *See, e.g., In re Primedia, Inc. S'holders Litig.*, 67 A.3d 455, 489-90, 495-96 (Del. Ch. 2013) (dismissing disclosure claim but preserving breach of loyalty claim based on continuing burden to show entire fairness of merger); *Aidinoff*, 900 A.2d at 667 (dismissing certain claims as time-barred because challenged business arrangements had been fully disclosed, but allowing timely claims for breach of duty of loyalty to proceed). Defendants cite no authority for the proposition that merely disclosing their breach of fiduciary duty would excuse this burden.

As a matter of fact, AR Capital's economic abuse of RCAP was never adequately disclosed to investors or to independent directors. Defendants cite, as their supposed "robust disclosure," a passage from an *RCS* prospectus that describes, in general terms, the allocation of the 10% percent commission among the various parties involved in the sales process. *See* Def. Br.18-19. At most, this describes how RCS does its wholesaling – it does not explain the larger economic context of RCAP's business, address which parties participate in the more lucrative management and advisory side of the REIT business, or disclose the economic arrangements that were being struck in fair market transactions by parties acting at arm's length. Nor does it disclose Defendants' intention to pour hundreds of millions of dollars into this unprofitable business to further AR Capital's interests.

Defendants' argument that "sophisticated" investors fully understood the "complained of arrangements" and "nevertheless supported and invested in RCAP" (Def. Br. 32), even if legally relevant, would at best present a fact issue inappropriate for resolution on a pleading motion. It is also directly contradicted by the Complaint, which contains well-pleaded allegations that even the independent directors did not understand the nature of AR Capital's financial exploitation of RCAP until after the StratCap acquisition was consummated. *See* ¶¶ 55-56, 92.

D. Allegations Regarding Gross, Intentional Overstaffing at Wholesale Are a Valid Part of the Overall Breach of Fiduciary Duty Claim

Defendants argue that one part of the breach of fiduciary duty narrative – the intentional and persistent overstaffing at Wholesale to drive sales for AR Capital regardless of the impact on RCAP's bottom line – cannot, standing alone, sustain a claim for breach of fiduciary duty. This fails on multiple grounds.

First, the question on a motion to dismiss is whether the "Complaint as a whole" supports a "reasonable inference" of breach of fiduciary duty; any "attempt to focus on each scheme individually" is improper. *In re Am. Int'l Grp., Inc.*, 965 A.2d at 795; *see also NACCO Indus., Inc. v. Applica Inc.*, 997 A.2d 1, 17 (Del. Ch. 2009) (while "each of the allegations in the Complaint, when viewed separately and in isolation, can be minimized . . . [the court's] task at the pleadings stage is . . . to draw reasonable inferences in favor of the plaintiff").

Second, contrary to Defendants' suggestion (Def. Br. 34), the Trust has not alleged a claim for corporate waste and therefore need not satisfy the heightened standard for such a claim – that the challenged expenditures literally served no corporate purpose. Courts frequently sustain breach of fiduciary duty claims based on facts that do not amount to corporate waste. *See, e.g.*, *TVI Corp.*

v. Gallagher, No. CV 7798-VCP, 2013 WL 5809271, at *17 (Del. Ch. Oct. 28, 2013) (dismissing corporate waste claim and retaining breach of loyalty claim, noting that standard for corporate waste is "onerous, stringent, extremely high, and very rarely satisfied"); *In re Ltd., Inc. S'holders Litig.*, No. CIV. A. 17148-NC, 2002 WL 537692, at *7 (Del. Ch. Mar. 27, 2002) ("Although the challenged transactions may be questioned because of doubts about the loyalty of the directors approving them, it does not necessarily follow that they constitute corporate waste.").

The Complaint alleges that the Control Defendants, seeking to drive sales regardless of the impact on RCAP, caused RCS to maintain inappropriately high staffing levels and continue pouring money into marketing efforts even as the business steeply declined. This reckless spending benefitted AR Capital, which enjoyed all of the upside of moving more product and increasing its income from assets under management while off-loading 75% of the costs onto RCAP's public shareholders. *See* ¶¶ 58-67. Defendants' repeated assertions that any marginal increase in sales flowing from this over-spending "would help RCS (and hence RCAP) make money" (Def. Br. 35), and would "increase revenues at RCS" and thus could not be "detrimental" to either RCS or RCAP (*id*. at 37) ignore the Complaint's detailed explanation that (1) Wholesale was only marginally profitable even when run properly, and (2) once the overstaffing began Wholesale lost money even at higher sales volumes. *See* ¶¶ 59-61.

Defendants' related argument that the overstaffing at RCS cannot be part of a duty of loyalty claim is based on a distortion of the pleaded facts regarding the individual Defendants' conflicted status. Defendants suggest that the interests of Mr. Weil and Ms. Quarto, the top RCAP executives, were always "aligned with the interest of RCAP and RCS" (Def. Br. 35-36) – ignoring that both of these officers also had fiduciary roles at AR Capital (*see* ¶¶ 19, 23), creating a classic two-hat conflict. *See Weinberger*, 457 A.2d at 710. The Complaint also alleges that both were long-time AR Capital insiders loyal to and controlled by Mr. Schorsch (¶ 38) – and, despite Defendants' attempt to minimize it, Mr. Weil's 3.51% interest in AR Capital was worth tens of millions of dollars. These concrete allegations of conflict stand in contrast to the vague, unsubstantiated speculations of director misconduct rejected in *Trenwick*, 906 A.2d at 210 (cited in Def. Br. 36).[7]

Defendants are forced to concede that those with a "larger interest in AR Capital" (*e.g.*, Mr. Schorsch) were not unconflicted fiduciaries for RCAP.

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[7] In light of the structural conflicts, Defendants' invocation of the business judgment rule (Def. Br. 38) is puzzling. None of the actions taken by these conflicted fiduciaries affecting the interests of both RCAP and AR Capital is entitled to a presumption of good faith.

They nevertheless ask the Court to accept their unproven conclusion that the overspending allegations assume "irrational behavior" and require "illogical inferences" because it was against AR Capital's interests to jeopardize their RCS marketing pipeline. Def. Br. 36. Once again, this argument ignores well-pleaded allegations as to how AR Capital allocated risks and benefits (*see* above at 38) and, in any event, at most posits questions for discovery and trial – not a basis for dismissing any part of the Complaint.

Defendants' argument that "the Complaint fails to allege any actual wrongdoing by any defendant in connection with the purported overstaffing" (Def. Br. 37) is incorrect. RCAP's conflicted managers were not just "aware that RCS had more salespeople than its competitors" (*id.*) – they failed to right-size staffing despite plummeting sales; continued to pour money into business development despite diminishing returns; and ignored warnings from Cetera management that RCAP was careening towards insolvency. *See* ¶¶ 65-66.

These allegations of an overarching policy, implemented by conflicted fiduciaries, to pour millions of dollars into pushing sales for AR Capital regardless of the cost-benefit analysis for RCAP, state a valid breach of loyalty claim – particularly when combined with the rest of the story told in the Complaint. This is a far cry from mundane, day-to-day business decisions presumed to be "not the subject of director attention," *In re Caremark Int'l Inc. Deriv. Litig.*, 698 A.2d 959, 968 (Del. Ch. 1996), or part of the mere "day-to-day activities of a company," *Rosenblatt v. Getty Oil Co.*, 493 A.2d 929, 943 (Del. 1985).

Defendants' invocation of the exculpation clause contained in RCAP's charter (Def. Br. 38) misses the mark. As Defendants recognize, exculpation does not apply to "breaches of the duty of loyalty, bad faith, or actions involving 'intentional misconduct or a knowing violation of law' or self-interestedness." *Id*. (citation omitted). Defendants' claim that "the Complaint contains no such allegations" (*id*.) is wishful thinking; self-interestedness is at the heart of all of the misconduct at issue here. Moreover, exculpation does not excuse gross negligence, a "flexible" and fact-intensive standard. *In re USA Detergents, Inc.*, 418 B.R. 533, 544 (Bankr. D. Del. 2009). Whether severe, intentional overspending to benefit AR Capital constitutes a "routine business decision[]" (Def. Br. 38), as opposed to reckless or intentional wrongdoing, is a matter for discovery and trial. Finally, where a complaint sets forth conduct that may go beyond mere negligence, allegations may not be dismissed at the pleading stage based on an exculpation clause. *See In re USA Detergents, Inc.*, 418 B.R. at 545.

E. Allegations Regarding Acquisitions Made to Serve AR Capital's Interests Are a Valid Part of the Breach of Fiduciary Duty Claim

Allegations regarding the acquisition of StratCap, SK Research, and Docupace are all validly included in the breach of fiduciary duty claim. Each transaction represented Control Defendants' willingness to spend public shareholders' money to serve AR Capital's interests, and each inflicted millions of dollars of needless injury that contributed to RCAP's failure.

Directors may be "interested" in a transaction even when they do not literally stand on both sides of the deal, if they may receive a benefit not equally available to all shareholders or their decisions may be influenced by extraneous factors. *See* above at 35-36. The Complaint's allegations regarding the three challenged acquisitions easily meet this standard, because each was undertaken primarily to serve the interests of AR Capital and bestowed significant benefits upon the Control Defendants not shared by RCAP's public shareholders. And these transactions were each undertaken with RCAP's money, most of which came from public stakeholders (creditors as well as shareholders).

As discussed in more detail above (at 25-29), the StratCap acquisition eliminated a competitor for AR Capital's products; provided AR Capital with long-sought access to "wire houses"; and expanded the very aspect of RCAP's business – wholesale – that it had led investors to believe it would deemphasize in favor of the more profitable retail business. *See* ¶¶ 90-91. The SK Research acquisition eliminated an independent watchdog that had been a thorn in AR Capital's side, while investing millions of dollars in an in-house research function that Defendants could not have believed would be accepted by the market as objective. ¶¶ 95-97, 99-101. And the Docupace acquisition shifted to RCAP the costs of developing software of use only to AR Capital, while purporting to launch a data-management business that, like SK Research, was likely to be rejected by the market as Schorsch-dominated. *See* ¶¶ 102, 106-07.

These allegations establish that AR Capital itself had interests in the three acquisitions not shared by RCAP and its public shareholders. The question whether the benefits of acquiring these companies (while offloading most of the cost on public stakeholders) was "material" to AR Capital is "predominantly a question of fact" not normally suited for disposition even on summary judgment, let alone a motion to dismiss. *See Pfeffer v. Redstone*, 965 A.2d 676, 685 (Del. 2009).

Defendants' principal response is to contend, yet again, that these benefits accrued equally to AR Capital *and* RCAP because both parties were in the business of selling AR Capital products. *See* Def. Br. 42, 44-45. Again, this ignores detailed allegations about the manner in which AR Capital allocated functions, expenses, and income between the two enterprises. It is not correct – and certainly cannot be assumed on a motion to dismiss – that RCAP benefitted equally when AR Capital sold more product. Any marginal increase in sales resulted in a real, long-lasting benefit to AR Capital, while Wholesale itself was rarely better than a break-even proposition, even at high sales volumes. *See* above at 17-21.

AR Capital's "interest" in the transactions attaches to each of the individual Defendants as well. Each held fiduciary roles at both RCAP and AR Capital, creating a classic structural conflict; each Control Defendant had a material financial interest in AR Capital; and each individual Defendant was loyal to and controlled by Mr. Schorsch – based not on "[c]onclusory allegations" (Def. Br. 42) but on a detailed pleading describing years of entangled interests and functional control. *See* above at 9, 12.

The cases cited by Defendants are not to the contrary. *Orman v. Cullman*, 794 A.2d 5 (Del. Ch. 2002), *denied* a motion to dismiss a breach of fiduciary duty claim because the facts alleged raised a "reasonable doubt" that a majority of the board was disinterested with respect to the challenged transaction – in one case merely because a $75,000 consulting agreement suggested domination by controlling shareholders. *In re Gen. Motors Class H S'holders Litig.*, 734 A.2d 611 (Del. Ch. 1999), in contrast, rejected an alleged conflict predicated solely on certain directors owning more of one class of stock than another – a fact substantially outweighed by their common interest in maximizing the value of the transaction. *See id*. at 617-18.

Finally, the Complaint adequately alleges that the challenged transactions were approved only by interested directors (*see* ¶¶ 97-98, 103-05) or by the full Schorsch-dominated board with no special committee (¶ 92). Defendants therefore cannot, as they try (Def. Br. 39), claim the protection of the business judgment rule with respect to these acquisitions.[8]

F. Allegations Regarding Proxy Solicitation Are a Valid Part of the Overall Breach of Fiduciary Duty Claim

Defendants again ignore the actual facts pleaded in seeking to dismiss allegations regarding the proxy solicitation fraud that became the final nail in RCS's coffin. Defendants argue for the inferences *they* wish to draw from the pleading – that the proxy fraud was committed by only a "handful" of RCS employees with no involvement or wrongdoing by the Control Defendants – while ignoring well-pleaded allegations that (1) the proxy solicitation served AR Capital's interests, not RCAP's; (2) the RCAP and RCS officers creating intense pressure on their employees to amass proxies were interested dual fiduciaries loyal

[8] Defendants' suggestion that the RCAP Board was not misled about StratCap's business model because RCAP's public filings (after the acquisition agreement was signed) mentioned that StratCap provided advisory services (Def. Br. 43-44) is irrelevant and misleading. RCAP's independent directors were not obligated to search its public filings to understand the proposed transaction. Rather, the Control Defendants had the duty to fully inform the Board about StratCap's business model and their plan to replace it with the off-market terms imposed upon RCS. *See In re Primedia, Inc. S'holders Litig.*, 67 A.3d at 495 (fiduciary duty of disclosure "unremitting"). And even full disclosure would not have cleansed this interested transaction absent approval by a majority of disinterested directors.

to AR Capital and Mr. Schorsch; (3) the MSD investigation led to a $3 million fine and the shuttering of RCS's operations in Massachusetts, suggesting more than isolated misconduct; and (4) the Sidley & Austin internal investigation indeed revealed a broader pattern of wrongdoing. *See* ¶¶ 115-22.

These allegations are more than adequate under the liberal Delaware pleading standard to support an inference of breach of fiduciary duty by the Control Defendants. *See In re Am. Int'l Grp., Inc.*, 965 A.2d at 795 (prior to full discovery, question is whether "Complaint as a whole" supports knowledge and involvement of Defendants, rather than adequacy of specific evidence tying each Defendant to each part of scheme).

II. COUNT II OF THE COMPLAINT ALLEGES A VALID CLAIM FOR AIDING AND ABETTING BREACH OF FIDUCIARY OF DUTY

As Defendants acknowledge, a party that lacks a direct fiduciary duty may be liable for aiding and abetting the breaches of other fiduciaries based on "knowing participation" in the underlying breach. *RBC Capital Mkts., LLC v. Jervis*, 129 A.3d 816, 861 (Del. 2015) (cited in Def. Br. 48). Defendants argue that Count II, standing alone, does not allege specific facts establishing "knowing participation," citing cases holding that such a claim cannot be based on "conclusory statements" or "merely reciting the elements of a claim without any factual support." Def. Br. 48, 50. Defendants announce that "the Trust does not allege a single fact supporting an inference of knowing participation by any of the defendants named in Count II." *Id*. at 49.

The problem with Defendants' argument is that Count II is pleaded entirely in the *alternative* and expressly incorporates by reference all the factual details set forth in the first 130 paragraphs of the Complaint. *See* ¶ 131. The purpose of Count II is simply to capture wrongful conduct by any of the individual Defendants who may prevail in arguing that they, as individuals, lacked a fiduciary duty to RCAP or RCS at any particular time. This is a perfectly appropriate approach. *See In re Nine Sys. Corp.*, No. CIV. A. 3940-VCN, 2014 WL 4383127, at *48 (Del. Ch. Sept. 4, 2014) (allowing aiding and abetting claim to be pled in alternative: "[i]n other words, the Plaintiffs are limited to one recovery – breach of fiduciary duty or aiding and abetting"). Count II's allegation of "knowing participation" is thus supported by all of the facts set forth in support of Count I, which amply satisfy notice pleading standards.

III. COUNT III OF THE COMPLAINT ALLEGES VALID CLAIMS FOR UNJUST ENRICHMENT AND CONSTRUCTIVE TRUST

Defendants' arguments to dismiss the Trust's claims for unjust enrichment and constructive trust once again ignore the realities of the parties' economic relationships and what the Complaint actually alleges. The core breach of fiduciary duty claim is that the Control Defendants siphoned profits away from

RCAP by awarding to AR Capital entities profitable advisory contracts that RCAP should have been able to retain for itself in return for allowing its subsidiary RCS to take on less profitable wholesaling obligations. Count III provides a standard remedy for this wrong by seeking disgorgement of proceeds of the breach from the AR Capital entities that received them. None of Defendants' arguments to dismiss this claim has merit.

First, Defendants argue that unjust enrichment is barred because the relationship between RCS and the Advisor Defendants was governed by contract. This is irrelevant, first, because the breach of fiduciary duty claim (and resulting unjust enrichment claim) are brought by RCAP, which was not a party to those contracts. In any event, the cases cited for this proposition hold only that an unjust enrichment claim cannot be based on the same contract that a plaintiff is suing to enforce – essentially that unjust enrichment is subsumed in the contract claim. *See, e.g.*, *Vichi v. Koninklijke Philips Elecs. N.V.*, 62 A.3d 26, 36, 59 (Del. Ch. 2012) (dismissing unjust enrichment claim arising out of contract that was basis for breach of contract claim); *Kuroda v. SPJS Holdings, L.L.C.*, 971 A.2d 872, 891 (Del. Ch. 2009) (same); *Bakerman v. Sidney Frank Importing Co.*, No. CIV. A. 1844-N, 2006 WL 3927242, at *19 (Del. Ch. Oct. 10, 2006) (barring unjust enrichment claim based on breach of fiduciary duties created by same contract underlying contract claim).

Here, in contrast, the Trust is not suing to *enforce* the agreements under which the advisory work was assigned to AR Capital entities – it alleges that those contracts were themselves the product of a breach of fiduciary duty. Unjust enrichment claims are not barred in such circumstances. *See, e.g.*, *Pfeiffer v. Leedle*, No. CV 7831-VCP, 2013 WL 5988416, at *10 (Del. Ch. Nov. 8, 2013) (unjust enrichment claim for receipt of excessive stock options not barred by contract governing award of options where plaintiff did not allege breach of contract and fiduciary obligations arose independently of contract); *Aidinoff*, 900 A.2d at 671 & n.24 (Del. Ch. 2006) (sustaining unjust enrichment claim against contractual recipient of fruits of breach of duty of loyalty; while existence of contracts "might complicate the applicability of this doctrine," claim could succeed if contracts were shown to have "resulted from fiduciarily-deficient behavior").

Second, Defendants' argument that the Trust has failed properly to allege "impoverishment" fails for multiple reasons. Once again it was *RCAP*, not *RCS* (*see* Def. Br. 54) that was impoverished by the diversion of profitable work to the Advisor Defendants. The argument is not that RCS (or, rather, an appropriate RCAP entity) did advisory work but was never paid for it (*see id.*), but rather that unconflicted fiduciaries for RCAP would have insisted on *obtaining* the more lucrative work as a condition of agreeing to take on the less profitable wholesaling obligations. It is similarly irrelevant that the Advisor Defendants actually did the work assigned them under the diverted contracts (although there were few actual duties associated with the sub-advisor agreements, and any such work was done by AR Capital employees – *see* ¶¶ 50-51). The unjust enrichment was the profit generated by these contracts – a portion of which rightfully should have gone to RCAP. The Complaint details the Control Defendants' roles in "devising" the challenged business arrangements and how they were enriched "as a result of the consequent impoverishment" (Def. Br. 55) – knowledge and actions that are imputed to the Defendant entities. *See Triton Constr. Co. v. E. Shore Elec. Servs., Inc.*, No. CIV. A. 3290-VCP, 2009 WL 1387115, at *16 (Del. Ch. May 18, 2009) (knowledge of officer or director imputed to corporation), *aff'd*, 988 A.2d 938 (Del. 2010).

Aidinoff is again particularly instructive on each of these points. There, claims for unjust enrichment and constructive trust were upheld against the entity, Starr, that received the benefits of unfair contracts with AIG, for the benefit of the AIG executives who owned Starr. In a scheme strikingly similar to the one here, the defendants caused AIG to pay certain expenses related to the diverted business, while leaving the profits at Starr. *See* 900 A.2d at 662-63. The plaintiffs alleged that "AIG could have performed the same function as Starr in-house, using many of the same personnel, and thereby captured more of the profit for itself." *Id.* at 663. The court found that Starr could be charged both with aiding and abetting breach of fiduciary duty and with unjust enrichment, since it "is fairly charged with the knowledge and conduct of its controlling persons." *Id*. at 671.

Aidinoff and other Delaware authority also put to rest Defendants' suggestion that the requirements for constructive trust are more onerous than the underlying standards to establish a breach of fiduciary duty and unjust enrichment; to the contrary, "[c]onstructive trusts are regularly imposed by courts of equity to remedy unjust enrichment." *Nash v. Schock*, No. 14721-NC, 1998 WL 474161, at *2 (Del. Ch. July 23, 1998), *quoted in Aidinoff*, 900 A.2d at 673 n.25. There is no rule that the party engaging in the misconduct must be the person against whom constructive trust is sought – a requirement that would "undercut much of the utility of the unjust enrichment cause of action" in recovering ill-gotten gains from entities acting without scienter but aligned with or controlled by wrongdoers. *Aidinoff*, 900 A.2d at 673 n.25. Thus, contrary to the suggestion that the Trust must prove a duty running directly from and breached by each Defendant entity (Def. Br. 57), it is sufficient to demonstrate a breach of fiduciary duty by the Control Defendants, whose knowledge and actions are attributed to the entities they own, control, and use as financial conduits.[9]

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[9] Defendants urge that no claim can lie against BDCA Advisor, which allegedly has been sold by an AR Capital affiliate to a third party. Def. Br. 57-58. This assertion, and its potential impact on the constructive trust remedy, is not properly before this court on a motion to dismiss.

CONCLUSION

For the foregoing reasons, the Defendants' Motion to Dismiss should be denied.

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