

REIT Directors Duck Investor Suit Over \$41M Loan Write-Down

By Hayley Fowler

Law360 (April 3, 2018, 4:47 PM EDT) -- A proposed class of Resource Capital Corp. shareholders can't pursue a suit on behalf of the real estate investment trust without the board of directors' go-ahead, a New York federal judge said Monday, finding the investors couldn't prove the board's permission was unnecessary given its alleged involvement in the underlying claims.

U.S. District Judge Louis L. Stanton dismissed the consolidated derivative shareholder action claiming the board mishandled a Puerto Rican hotel loan portfolio that prompted a \$41 million write-down in 2015, saying named plaintiffs Joseph Greenberg and James M. DeCaro didn't meet the exception to a Maryland law requiring investors who file a shareholder derivative action to first ask the board to bring the litigation itself.

"Taken singly or cumulatively, the allegations in the complaint do not show with the particularity required by Maryland law that the board could not fairly evaluate a demand," Judge Stanton said.

Greenberg and DeCaro, among others, filed proposed class actions last year seeking to represent a class of shareholders and the REIT itself. The suits, which were later consolidated in New York federal court, accused the board, Resource Capital's external manager Resource Capital Manager Inc. and its parent company Resource America Inc. of contributing to a \$68.4 million loss in the REIT's market capitalization by holding on to a precariously positioned mezzanine loan.

But Judge Stanton sided Monday with the directors' motion to dismiss, saying investors skirted Maryland law — where Resource Capital is based — by failing to place a demand on the board to bring the litigation itself.

Investors had said an exception to the demand requirement existed under a Maryland Court of Appeals decision allowing that such a request is futile when directors are "so personally and directly conflicted or committed" to the alleged misconduct that they likely won't respond in good faith to the shareholders' demand.

The investors said the directors had covered up Resource Capital's exposure to the unstable Puerto Rican economy through a \$38 million loan secured by luxury hotels there. According to the opinion, the \$38 million loan became a \$41 million write-down when the company eventually disclosed in August 2015 that Puerto Rico's struggling economy made repayment unlikely.

But the judge rejected that claim, finding the board's approval of U.S. Securities and Exchange

Commission filings and other public statements concerning the loan coupled with their service on other board committees didn't make investors' demand futile.

"We are pleased with the court's decision, which dismissed all of the plaintiffs' claims and recognized that the plaintiffs had failed to plead any reason to second guess the good faith or business judgment of Resource Capital's board," Mark Gimbel of Covington & Burling LLP, who represents the board and officers, said in an email to Law360 on Tuesday.

Craig W. Smith of Robbins Arroyo LLP, who is representing the investors, said they were disappointed by the decision. "We believe the facts alleged demonstrate the futility of making a litigation demand on the board of directors, even under Maryland's challenging standard," Smith said in an email to Law360 on Tuesday. "We are evaluating next steps, including whether to pursue an appeal."

Investors also said former CEO Jonathan Cohen and his family — who controlled 30 percent of Resource Capital's total shares — exerted excessive control over the board and were unjustly enriched by a pricey management agreement

Judge Stanton also nixed those allegations, pointing out that Cohen and his father, who served on the board, left their positions and divested their stock when its parent company Resource America was bought by C-III Capital Partners LLC in 2016.

"The complaint leaves it as no more than a suspicion that the Cohen family controlled any Resource Capital directors," he said.

The officer defendants named in the suit are Cohen, Senior Vice President and Chief Financial Officer David Bryant, Vice President and Chief Accounting Officer Eldron C. Blackwell and David E. Bloom, a senior vice president at both Resource Capital and Resource America.

The current and former board members named are Steven J. Kessler, Walter T. Beach, Edward E. Cohen, Jonathan Z. Cohen, Richard L. Fore, William B. Hart, Gary Ickowicz, Murray S. Levin, P. Sherrill Neff and Stephanie H. Wiggins.

Counsel for Resource America Inc. and Resource Capital Manager Inc. as well as counsel for Resource Capital declined to comment Tuesday.

Representatives from Resource America, Resource Capital Manager and Resource Capital did not respond to requests for comment.

The investors are represented by Brian J. Robbins, Craig W. Smith and Shane P. Sanders of Robbins Arroyo LLP.

The individual officers and board members are represented by Mark Gimbel, Christopher Y. L. Yeung, William O'Neil, Ben Salk and Laena St. Jules of Covington & Burling LLP.

Resource Capital, as a nominal defendant, is represented Bradley J. Nash of Schlam Stone & Dolan LLP.

Resource America and Resource Capital Manager are represented by David A. Picon and Edward J. Canter of Proskauer Rose LLP.

The suit is In re: Resource Capital Corp. Shareholder Derivative Litigation Demand Futile Actions, case number 1:17-cv-00253, in the U.S. District Court for the Southern District of New York.

--Editing by Brian Baresch.

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