



**IN THE COURT OF CHANCERY OF THE STATE OF DELAWARE**

IN RE MORGANS HOTEL GROUP            ) CONSOLIDATED  
CO. STOCKHOLDER LITIGATION        ) C.A. No. 12433-VCL

**ORDER GRANTING MOTION TO DISMISS**

1. The plaintiffs are former holders of common stock issued by non-party Morgans Hotel Group Co. (“Morgans” or the “Company”). In 2016, Morgans merged with a wholly owned subsidiary of SBEEG Holdings, LLC (“SBE”), and each share of Morgans common stock was converted into the right to receive \$2.25 in cash (the “Merger”). In their Verified Second Consolidated Amended Class Action Complaint (the “Complaint”), the plaintiffs contend that the Merger resulted from breaches of fiduciary duty or, alternatively, caused unjust enrichment. The defendants have moved to dismiss the Complaint pursuant to Rule 12(b)(6). The motion is evaluated using the standard set forth in *Savor, Inc. v. FMR Corp.*, 812 A.2d 894, 896-97 (Del. 2002). The motion is granted.

2. Count I of the Complaint alleges that the “Yucaipa Defendants” breached their fiduciary duties in connection with the Merger. The Complaint uses the term “Yucaipa Defendants” to refer collectively to Ron Burkle, The Yucaipa Companies, LLC (an entity that Burkle founded and controls), and five Burkle/Yucaipa affiliates (Yucaipa American Alliance Fund II, L.P., Yucaipa American Alliance (Parallel) Fund II, L.P., Yucaipa American Alliance Fund II, LLC., Yucaipa American Funds, LLC, and Yucaipa American Management, LLC). The Complaint contends that the Yucaipa Defendants controlled Morgans for purposes of the decision to engage in the Merger, owed fiduciary duties

because of their control, and breached their fiduciary duties by extracting unique benefits to the detriment of the Company's common stockholders.

a. A stockholder will be treated as a controller that owes fiduciary duties if it "owns a majority interest in . . . the corporation." *Kahn v. Lynch Commc'n Sys., Inc.*, 638 A.2d 1110, 1113-14 (Del. 1994) (internal quotation marks omitted). The Yucaipa Defendants did not own a majority of Morgans' common stock. Burkle owned 22,367 shares of common stock, representing only 0.00064% of Morgans' outstanding shares.

b. A non-majority stockholder will be treated as a controller that owes fiduciary duties if, despite not owning a majority interest in the corporation, the stockholder "exercises control over the business affairs of the corporation." *Id.* (internal quotation marks omitted). The non-majority stockholder must "have such formidable voting and managerial power" that, as a practical matter, the non-majority stockholder is "no differently situated than if [it] had majority voting control." *In re PNB Hldg. Co. S'holders Litig.*, 2006 WL 2403999, at \*9 (Del. Ch. Aug. 18, 2006). Under this standard, a "large blockholder will not be considered a controlling stockholder unless they actually control the board's decisions about the challenged transaction." *In re Crimson Expl. Inc. S'holder Litig.*, 2014 WL 5449419, at \*12 (Del. Ch. Oct. 24, 2014). To make the necessary showing, "the minority blockholder's power must be so potent that independent directors cannot freely exercise their judgment." *In re Morton's Rest. Gp. S'holders Litig.*, 74 A.3d 656, 665 (Del. Ch. 2013).

c. The plaintiffs attempt to make the necessary showing by citing contractual blocking rights that the Yucaipa Defendants possessed. The Yucaipa

Defendants gained these rights in 2009 when Yucaipa American Alliance Fund II, L.P. and Yucaipa American Alliance (Parallel) Fund II, L.P. invested \$75 million in Morgans in return for (i) 75,000 shares of Morgans' Series A Preferred Stock and (ii) warrants to purchase 12,500,000 shares of Morgans' common stock at an exercise price of \$6.00 per share. Compl. ¶ 42.

d. The Series A Preferred Stock required the consent of the Yucaipa Defendants for any transaction:

a. involving the acquisition (including by merger, consolidation, other business combination, or acquisition of all or substantially all of the assets of the Company, other than an acquisition that is an acquisition of substantially all of the assets of the Company as a result of the disposition by the company of real estate assets where the Company will continue to engage in the business of managing hotel properties and other real property assets) of the Company by any third party; or

b. pursuant to which the Series A Preferred Securities are converted or reclassified into or exchanged for securities of another entity.

*Id.* ¶ 44.

e. Under the securities purchase agreement that governed the 2009 transaction, the Yucaipa Defendants possessed another set of consent rights. As long as the Yucaipa Defendants had the right to exercise the warrants to purchase at least 6,250,000 shares of the Company's common stock, then their consent was required for:

a. the sale or transfer of all or substantially all of the assets of the Company and its subsidiaries, taken as a whole, to any third party;

b. any transaction involving the acquisition (including by merger, consolidation, other business combination, or acquisition of all or substantially all of the capital stock or assets of any third party) of any third party by the Company or any of its subsidiaries where the equity investment by the Company and its subsidiaries is \$100,000,000 or greater;

c. any transaction involving the acquisition (including by merger, consolidation, other business combination, or acquisition of all or substantially all of the assets of the Company and its subsidiaries, taken as a whole other than acquisition that is an acquisition of substantially all of the assets of the Company and its subsidiaries, taken as a whole, as the result of the disposition by the Company or its subsidiaries of real estate assets where the Company and its subsidiaries, taken as a whole, will continue to engage in the business of managing hotel properties and other real property assets) of the Company by any third party;

d. any change in the size of the Board to a number below seven (7) or above nine (9); and

e. the entry into any contract, agreement, arrangement or transaction (or series of related contracts, agreements, arrangements or transactions) with respect to any of the foregoing actions.

*Id.* ¶ 46.

f. The plaintiffs argue with some force that during the period leading up to the Merger, Morgans was in financial distress. They argue that, in that context, the Yucaipa Defendants' ability to foreclose important transactional alternatives amounted to effective control for purposes of the decision to enter into the Merger. But Delaware courts have rejected this argument. *See Thermopylae Capital P'rs, L.P. v. Simbol, Inc.*, 2016 WL 368170, at \*13 (Del. Ch. Jan. 29, 2016) ("The Plaintiffs here have alleged the existence of a contractual right, which permitted MDV to restrict corporate action, thus giving it leverage over the Board. Holding, even exercising, this right does not make MDV a controller owing fiduciary duties to the Plaintiffs."); *Superior Vision Servs., Inc. v. ReliaStar Life Ins. Co.*, 2006 WL 2521426, at \*4 (Del. Ch. Aug. 25, 2006) ("[A] significant shareholder, who exercises a duly-obtained contractual right that somehow limits or

restricts the actions that a corporation otherwise would take, does not become, without more, a ‘controlling shareholder.’”).

g. In an effort to distinguish the current situation and bolster their allegations regarding control, the plaintiffs have included in the Complaint allegations about historical events involving the Yucaipa Defendants and Morgans, including rulings this court made in previous litigation. *See OTK Assocs., LLC v. Friedman*, 85 A.3d 696 (Del. Ch. 2014). Those allegations relate to a different point in the Company’s history when the Yucaipa Defendants possessed a different package of rights. The allegations do support a reasonable inference that Burkle has long wanted to acquire Morgans or, at a minimum, certain of its hotels. They also support a reasonable inference that Burkle is an aggressive bargainer who seeks to use whatever leverage he possesses. They do not alter the factual landscape regarding the Yucaipa Defendants’ rights vis-à-vis Morgans during the period leading up to the Merger.

h. The Complaint does not support a reasonable inference that the Yucaipa Defendants were fiduciaries during the period leading up to the Merger. Count I is therefore dismissed.

3. Count II of the Complaint alleges that that the Yucaipa Defendants were unjustly enriched by the Merger. “The elements of unjust enrichment are: (1) an enrichment, (2) an impoverishment, (3) a relation between the enrichment and impoverishment, (4) the absence of justification, and (5) the absence of a remedy provided by law.” *Nemec v. Shrader*, 991 A.2d 1120, 1130 (Del. 2010). Delaware courts “have

consistently refused to permit a claim for unjust enrichment when the alleged wrong arises from a relationship governed by contract.” *Id.*

a. “[W]here a breach of fiduciary duty claim based on the same facts and circumstances fails, the Court often dismisses the corresponding unjust enrichment claim.” *In re Molycorp, Inc. S’holder Deriv. Litig.*, 2015 WL 3454925, at \*11 (Del. Ch. May 27, 2015). A combination of “validly negotiated contract rights and the failure to allege culpable conduct” operates to defeat a claim that the defendants “lacked justification for their gains.” *Id.*

b. The facts alleged in the Complaint do not support a claim for unjust enrichment. The Yucaipa Defendants owned Series A Preferred Stock and warrants, and they possessed a package of rights that included contractual blocking rights. The Yucaipa Defendants bargained for consideration based on the package of rights they held. Other than the claim for breach of fiduciary duty, which fails, the plaintiffs have not articulated a theory of culpable conduct by the Yucaipa Defendants that would result in them having been unjustly enriched. The Yucaipa Defendants were enriched by the Merger, but the Complaint does not support a reasonably conceivable inference that the enrichment was unjust. Count II is therefore dismissed.

4. Count III of the Complaint alleges that defendant Bradford B. Nugent breached his fiduciary duties in his role as a director of Morgans. The Yucaipa Defendants appointed Nugent to the board of directors of Morgans pursuant to an appointment right they possessed under the securities purchase agreement. The Complaint does not allege that Nugent has any other ties to the Yucaipa Defendants.

a. “Delaware law clearly prescribes that a director who plays no role in the process of deciding whether to approve a challenged transaction cannot be held liable on a claim that the board’s decision to approve that transaction was wrongful.” *In re Tri-Star Pictures, Inc., Litig.*, 1995 WL 106520. At \*2 (Del. Ch. Mar. 9, 1995); *see also In re Wheelabrator Techs. Inc. S’holder Litig.*, 1992 WL 212595, at \*10 (Del. Ch. Sept. 1, 1992) (“Waste’s designees on WTI’s board violated no fiduciary duties since they did not participate in the merger negotiations on WTI’s behalf.”); *Citron v. E.I. Du Pont de Nemours & Co.*, 584 A.2d 490, 499 (Del. Ch. 1990) (holding that claim could not be asserted against directors who did not play a role in the board’s decision-making process).

b. The Complaint makes only two references to Nugent’s participation in the process. First, Nugent expressed support for the Merger. Compl. ¶ 114. Second, Nugent reiterated that the Yucaipa Defendants supported the Merger after Burkle himself attended a board meeting and said the same thing. *Id.* ¶ 143. The Complaint recognizes that Nugent recused himself at all relevant times during the deliberations regarding the Merger. He also recused himself from the board vote to approve the Merger. Compl. ¶¶ 126, 132, 143, 150, 157, 184, 191-92, 201, 214, 255-58.

c. It is not reasonably conceivable that these facts could support a claim for breach of fiduciary duty against Nugent. Count III is therefore dismissed.

  
Vice Chancellor Laster  
October 24, 2017