

No. 1-11-0388

NOTICE: This order was filed under Supreme Court Rule 23 and may not be cited as precedent by any party except in the limited circumstances allowed under Rule 23(e)(1).

IN THE APPELLATE COURT
OF ILLINOIS
FIRST JUDICIAL DISTRICT

DEAN KONSTAND, derivatively on behalf of)	Appeal from the
Prime Group Realty Trust,)	Circuit Court of
)	Cook County
Plaintiff-Appellant,)	
)	No. 09 CH 40152
v.)	
)	Honorable
PRIME GROUP REALTY TRUST, THE)	Sophia Hall,
LIGHTSTONE GROUP, LLC, PRIME OFFICE)	Judge Presiding.
COMPANY, LLC, DAVID LICHTENSTEIN,)	
JEFFREY A. PATTERSON, JOHN A. SABIN,)	
MICHAEL M. SCHURER, SHAWN R.)	
TOMINUS, BRUNO DE VINCK, GEORGE R.)	
WHITTEMORE, and PEYTON H. OWEN, JR.,)	
)	
Defendants-Appellees.)	

JUSTICE STERBA delivered the judgment of the court.
Justices Fitzgerald Smith and Pucinski concurred in the judgment.

ORDER

¶ 1 *HELD:* The circuit court did not err in dismissing the amended complaint with prejudice where the dividend payments did not violate Maryland law. Moreover, plaintiff's conclusory statements were insufficient to plead corporate waste or bad faith. Thus, the complaint failed to state a cause of action upon which relief may be granted.

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¶ 2 Plaintiff-appellant Dean Konstand filed a shareholder derivative action on behalf of Prime Group Realty Trust (PGRT) against defendants-appellees PGRT, Prime Office Company, LLC (Prime Office), The Lightstone Group, LLC (Lightstone), David Lichtenstein, Jeffery A. Patterson, John A. Sabin, Michael M. Schurer, Shawn R. Tominus, Bruno de Vinck, George R. Whittemore, and Peyton H. Owen, Jr., (collectively Board), alleging breach of fiduciary duty. The circuit court granted defendants' motion to dismiss filed pursuant to section 2-615 of the Illinois Code of Civil Procedure (Code) (735 ILCS 5/2-615 (West 2008)). On appeal, Konstand contends that the circuit court erred in dismissing his complaint where: (1) he properly pled breaches of fiduciary duty on the basis of three common shareholder dividend payments, (2) he properly pled that demand on PGRT's Board was futile, and (3) the failure to allege insolvency is not fatal to his breach of fiduciary duty claims. For the following reasons, we affirm the judgment of the circuit court.

¶ 3 **BACKGROUND**

¶ 4 PGRT was organized in 1997 as a Maryland real estate investment trust with primary real estate holdings located primarily in the Chicago area. Two classes of shares in PGRT were issued, common shares and series B preferred shares. Under PGRT's Articles of Incorporation (Articles), its Board is granted "full, exclusive and absolute power, control and authority" over the property and business of PGRT. The Articles further provide that PGRT's preferred shareholders are entitled to fixed quarterly dividends, a liquidation preference of \$25 per share, and the right to elect two board members in the event that preferred dividends are not paid for six consecutive quarters. The preferred share dividends are cumulative, so that even if the Board

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exercises its discretion and opts not to pay the dividends in a given quarter, the dividends continue to accrue. The Articles prohibit the payment of common share dividends unless PGRT is current on all preferred dividend payments. Konstand has owned preferred shares since October 2004. He currently owns 3,507.895 preferred shares in PGRT.

¶ 5 Common shares of PGRT were traded on the New York Stock Exchange from November 12, 1997 until July 1, 2005, at which time Prime Office acquired all of PGRT's common shares in a merger transaction. Prime Office is a wholly owned subsidiary of Lightstone, which is owned by Lichtenstein. Following the acquisition, PGRT's Board consisted of: Lichtenstein, Chairman and Principal of Lightstone; Patterson, PGRT's President and Chief Executive Officer; Schurer, Chief Financial Officer of Lightstone; de Vinck, Senior Vice President of Lightstone; and three independent members, Whittemore, Sabin and Tominus. In 2007, Owen, President and Chief Operating Officer of Lightstone, replaced Schurer on the Board.

¶ 6 Between 2005 and mid-2008, the Board declared three common dividend distributions to Prime Office, the sole common shareholder. The first dividend of \$30 million was paid in July 2005, a second dividend of \$76 million was paid in February 2006, and a third dividend of \$15 million was paid in May 2008. At the time of the first dividend, PGRT had a cash balance of \$70 million. In January 2006, just prior to the declaration of the second dividend, PGRT obtained loans totaling \$113 million, secured by real estate owned by PGRT.

¶ 7 On October 20, 2009, Konstand filed a shareholder derivative action alleging that the July 2005 and February 2006 dividend distributions constituted a breach of fiduciary duty. Konstand stated that he filed the action on behalf of himself and all preferred shareholders

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similarly situated for the benefit of PGRT. Konstand alleged that Lightstone and Lichtenstein used their control of PGRT to engage in a scheme of corporate waste and looting. Konstand further stated that the dividend distributions and the obtained loans were not based upon any legitimate business purpose and were not made in the best interest of PGRT. The complaint alleged that the Board owed a fiduciary duty to the preferred shareholders and to the company itself, and that it breached that duty when it distributed the two dividend payments. The circuit court found that all of the allegations regarding breach of fiduciary duty were conclusory and that more facts were necessary. The court further found that there were no allegations in the complaint that the contract governing the preferred shareholders' entitlement to dividends was breached, or that the Maryland statute governing the distribution of dividends was violated. Finally, the court found that the allegations regarding demand futility were conclusory. The complaint was therefore dismissed without prejudice.

¶ 8 On October 2, 2010, Konstand filed an amended complaint in which he extended his breach of fiduciary duty claims to include the May 2008 dividend distribution. The amended complaint also included direct quotes from U.S. Securities and Exchange Commission (SEC) filings relating to the control of PGRT and the fact that the majority of the Board members were not independent. The complaint included additional quotes from SEC filings related to PGRT's operating losses and insufficient cash resources. The breach of fiduciary duty counts were amended to include allegations that the Board violated the standard of care required under the Maryland business judgment rule. On January 5, 2011, the circuit court dismissed the amended complaint with prejudice, finding that the complaint failed to allege facts to support the

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proposition that the dividend payments caused insolvency in violation of Maryland law.

Konstand timely filed this appeal.

¶ 9

ANALYSIS

¶ 10 A motion to dismiss under section 2-615 of the Code attacks the legal sufficiency of the complaint. *Canel v. Topinka*, 212 Ill. 2d 311, 317 (2004). It does not raise affirmative factual defenses but alleges only defects appearing on the face of the complaint. *Canel*, 212 Ill. 2d at 317. Thus, the question that is presented by a section 2-615 motion is whether the allegations of the complaint, when viewed in a light most favorable to the plaintiff, are sufficient to state a cause of action upon which relief may be granted. *Canel*, 212 Ill. 2d at 317. The cause of action should be dismissed only if it is clearly apparent that no set of facts can be proven that will entitle the plaintiff to recovery. *Canel*, 212 Ill. 2d at 318. A reviewing court determines *de novo* whether the trial court should have granted a section 2-615 motion to dismiss. *Canel*, 212 Ill. 2d at 318.

¶ 11 Konstand argues that the circuit court erred in dismissing his complaint because he adequately pled breaches of fiduciary duty where he alleged that the 3 dividend distributions in question contributed to PGRT's cash flow problems that eventually required the attempted sale of the company. Konstand also argues that he adequately pled that demand on the Board was futile, as required for a shareholder to bring a derivative action without first making a demand on the Board to pursue the claim on behalf of the company. Finally, Konstand contends that the circuit court erred in dismissing his complaint on the grounds that he did not plead that the payment of the dividends rendered PGRT insolvent because a breach of fiduciary duty can still

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occur even if the dividend payments complied with the applicable statute.

¶ 12 Because PGRT is incorporated in Maryland, this court will apply the substantive law of Maryland to these issues. See *Spillyards v. Abboud*, 278 Ill. App. 3d 663, 667 (1996) (on issues related to corporate governance, Illinois courts apply the law of the state of incorporation). In the absence of Maryland law on corporate governance issues, Maryland courts look to Delaware law. See *Jolly Roger Fund LP v. Sizeler Property Investors, Inc.*, No. RDB 05-841, 2005 WL 2989343 at *3 (D. Md. 2005). Section 2-311 of the Maryland Code provides:

"(a)(1) No distribution may be made if, after giving effect to the distribution:

(i) The corporation would not be able to pay indebtedness of the corporation as the indebtedness becomes due in the usual course of business; or

(ii) *** the corporation's total assets would be less than the sum of the corporation's total liabilities plus, unless the charter permits otherwise, the amount that would be needed, if the corporation were to be dissolved at the time of the distribution, to satisfy the preferential rights upon dissolution of stockholders whose preferential rights on dissolution are superior to those receiving the distribution." Md. Code Ann., Corps. & Ass'ns §2-311(a)(1) (West 2008).

¶ 13 Although this statute, referred to by the circuit court and the parties as the "dividend statute," was relied on by the circuit court in its finding that Konstand failed to state a cause of

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action upon which relief may be granted, Konstand dismisses this statute as "irrelevant" in his briefs. He first claims that the dividend statute "simply limits dividend distributions for insolvent or soon to be insolvent companies." In his reply brief, Konstand asserts that the dividend statute "simply confers the right to issue dividends." He does not cite to any case law for either of these assertions, and we decline to read these interpretations into the purpose of this statute. The title of section 2-311 is "Limitations on distributions." The statute clearly details the circumstances under which dividend distributions are prohibited for all companies.

¶ 14 In arguing that the dividend distributions constituted a breach of fiduciary duty, Konstand never suggests that the Board violated Maryland's dividend statute. Rather, he contends that the Board can still breach its fiduciary duty even if it complies with the dividend statute, relying on *Sinclair Oil Corp. v. Levien*, 280 A.2d 717, 721 (Del. 1971), in which the court stated that even when a company complies with the applicable statute, a court can still interfere with dividend payments if the plaintiff can prove that a particular dividend was not grounded on any reasonable business objective. In his reply brief, Konstand further relies on a footnote in *Renbaum v. Custom Holding, Inc.*, 386 Md. 28, 54 n.22 (2005), in which the court stated that "the decision to distribute dividends is a discretionary act by the board of directors in most cases and may be subject to review under the business judgment rule."

¶ 15 However, we note that although Konstand cites the Maryland business judgment rule statute (Md. Code Ann., Corps. & Ass'ns §2-405(1)(a) (West 2008)) in his reply brief, he never provides the text of this statute and does not cite any cases in which the statute was determined to have been violated. Indeed, he does not even argue that the Board violated this statute.

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Similarly, Konstand does not argue that he pled facts sufficient to show, as stated in *Sinclair Oil*, that any of the dividend payments he challenges were not grounded on any reasonable business objective. Instead, Konstand merely states that the Board breached its fiduciary duty by wasting PGRT's assets through the payment of excessive dividends in bad faith, relying on quotes from various SEC filings related to cash flow problems. Konstand cites no case law to support his claims of corporate waste and bad faith.

¶ 16 It is well settled that "[m]ere contentions without argument or citation to authority do not merit consideration on appeal." *Eckiss v. McVaigh*, 261 Ill. App. 3d 778, 786 (1994).

"[A]rguments inadequately presented on appeal are waived." *Id.* A reviewing court is "not a repository into which the appellant may foist the burden of argument and research." *Velocity Investments, LLC v. Alston*, 397 Ill. App. 3d 296, 297 (2010). Therefore, this court will address Konstand's arguments only to the extent that he has developed those arguments in his briefs. Konstand devotes the bulk of his argument section to the three dividend payments and the additional loans taken out by PGRT to fund the second dividend payment, but his argument consists primarily of conclusory statements about corporate waste and looting.

¶ 17 Moreover, the cases Konstand relies on do not support his arguments. In *Sinclair Oil*, the parent company owned about 97% of its subsidiary's stock and nominated all members of its board of directors. *Sinclair Oil*, 280 A.2d at 719. Over a 6 year period, the board of directors authorized the payment of \$108,000,000 in dividends, which exceeded the subsidiary's earnings in that period by \$38,000,000. Although the payments were still made in compliance with a Delaware statute authorizing payment of dividends out of surplus or net profits, the plaintiff in

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Sinclair Oil argued that the decision to pay the dividends was based on an improper motive. *Id.* at 720-21.

¶ 18 The court in *Sinclair Oil* noted that because the dividends complied with the Delaware statute, "the alleged excessiveness of the payments alone would not state a cause of action." *Id.* at 721. The court went on to state:

"Nevertheless, compliance with the applicable statute may not, under all circumstances, justify all dividend payments. If a plaintiff can meet his burden of proving that a dividend cannot be grounded on any reasonable business objective, then the courts can and will interfere with the board's decision to pay the dividend." *Id.*

¶ 19 However, the court concluded that the plaintiff in *Sinclair Oil* had not met this burden where he simply argued that the dividend payments drained the subsidiary of cash to the extent that it was unable to expand. *Id.* at 722. Instead of bolstering Konstand's argument, this case does the opposite. Alleged excessiveness of the payments alone is not sufficient grounds for stating a cause of action. Even if this case does stand for the proposition that mere compliance with the applicable statute may not be enough to justify all dividend payments, Konstand has not adequately pled facts sufficient to show that any of the three dividend payments were not grounded on any reasonable business objective. Instead, he simply concludes that certain negative or cautionary statements, in various SEC filings and letters spanning 6 years, demonstrate that the three dividend payments constituted corporate waste and looting.

¶ 20 Similarly, Konstand's reliance on *Renbaum* is misplaced. Konstand focuses on the

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language in *Renbaum* that states that the distribution of dividends may be subject to the business judgment rule, and appears to ignore the language stating that the distribution of dividends is a discretionary act. See *Renbaum*, 386 Md. at 54 n.22. Moreover, Konstand does not even describe what the business judgment rule is, nor does he suggest that the Board failed to comply with this statute in any way.

¶ 21 Although Konstand's complaint alleges that the Board breached its fiduciary duty to both the preferred shareholders and PGRT, the appellees correctly note that, in general, the only duties owed to preferred shareholders are contractual. See *Blue Chip Capital Fund II Ltd Partnership v. Tubergen*, 906 A.2d 827, 834 (Del. Ch. 2006). Konstand appears to concede this point, stating in his reply brief that he merely seeks to vindicate PGRT's rights. Thus, Konstand's argument on appeal is that the Board breached its fiduciary duty to PGRT through corporate waste and bad faith in spite of the fact that the Board did not violate Maryland's dividend statute.

¶ 22 In *Sinclair Oil*, the court stated that under the business judgment rule, "a court will not interfere with the judgment of a board of directors unless there is a showing of gross and palpable overreaching." *Sinclair Oil*, 280 A.2d at 720. Even if we were to agree with Konstand that mere compliance with the dividend statute was insufficient, Konstand has pled no facts to show that the three dividend payments constituted "gross and palpable overreaching." It is well settled that the payment of dividends rests in the discretion of the board of directors and that courts will not interfere with the judgment of the board unless fraud or gross abuse of discretion have been shown. *Gabelli & Co. v. Liggett Group, Inc.*, 479 A. 2d 276, 280 (Del. 1984). See

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also *Wittman v. Crooke*, 120 Md. App. 369, 376 (1998) (noting that the party challenging the validity of a board's actions must produce evidence sufficient to rebut the presumption that the directors acted in good faith and in the best interest of the corporation and that a showing must be made of fraud, self-dealing or unconscionable conduct to justify judicial review).

¶ 23 Konstand asks this court to rule that compliance with the Maryland dividend statute alone does not absolve the Board of liability for breach of fiduciary duty through corporate waste and bad faith, yet he does not phrase his arguments in the language of the cases he relies upon for this proposition. Rather than arguing that the dividend payments were not based on any reasonable business objective or that the Board violated the business judgment rule, Konstand simply contends that the dividend payments were made in bad faith and constituted corporate waste. However, he has cited no case law discussing what constitutes corporate waste or bad faith.

¶ 24 Bad faith on the part of a board "will be inferred where 'the decision is so beyond the bounds of reasonable judgment that it seems essentially inexplicable on any [other] ground.'" *In re Rexene Corp. Shareholders Litigation*, Nos. 10, 897, 11,300, 1991 WL 77529 at *4 (quoting *In re J.P. Stevens & Co. Shareholders Litigation*, 542 A.2d 770, 780 (Del. Ch. 1988)). Thus, the test for bad faith is just as stringent, if not more so, than the test in *Sinclair Oil*. A transaction constitutes corporate waste if " 'what the corporation has received is so inadequate in value that no person of ordinary, sound business judgment would deem it worth what the corporation has paid.'" *Id.* (quoting *Saxe v. Brady*, 184 A.2d 602, 610 (Del. Ch. 1962)). Where the transaction in question is a dividend payment, the size of the dividend cannot be compared to any amount

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received by the corporation, so the test for waste is the same as the test for bad faith. *Id.*

¶ 25 A Maryland court in another suit involving the same defendants and the same dividend distributions dealt with the issue of bad faith in an unpublished opinion in *Jolly Roger Fund, LP v. Prime Group Realty Trust*, No. 24-C-06-010433, 2007 Md. Cir. Ct. LEXIS 10 (Aug. 16, 2007). Although the court in *Jolly Roger* was addressing the issue of the contractual rights of the preferred shareholders, its determination on the issue of good faith and fair dealing is relevant here. After noting that the Board had extensive authority to conduct PGRT's affairs, the court concluded:

"None of the transactions, sales, or other related events as presented to this Court demonstrate that PGRT acted in bad faith, or otherwise rendered PGRT an empty shell of a company. PGRT unquestionably remains a going concern." *Id.* at *21.

¶ 26 Konstand provides selective financial data relating to cash on hand at the time of the first dividend payment, and makes references to outstanding debt, but provides no additional financial information about PGRT's overall condition at any specific time. He quotes from a letter sent to the preferred shareholders in 2011, nearly 6 years after the first dividend distribution, in which PGRT urges the shareholders to approve a possible merger because without the merger, PGRT would be unable to generate sufficient cash flow to sustain its operations. However, this is not sufficient to support allegations that PGRT's situation in 2011 was a direct result of the dividend payments, nor that the Board authorized the payments in bad faith.

¶ 27 Moreover, Konstand has provided no facts to show that the decision to authorize the

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three dividend payments in question was so beyond the bounds of reasonable judgment as to seem inexplicable or that the dividend payments were not grounded on any reasonable business objective, and he has pled no facts to show gross-overreaching, self-dealing or unconscionable conduct. The Maryland dividend statute provides clear guidelines for what constitutes excessive dividend payments. In the absence of pleading facts that would show that PGRT violated this statute, the only way Konstand can survive a motion to dismiss is by pleading facts to show that one of the other tests he relies on were met, or facts that would show that, in spite of compliance with the statute, the dividend payments were made in bad faith.

¶ 28 Because the dividend payments did not violate Maryland law and Konstand has pled no facts that show evidence of bad faith or corporate waste despite the Board's compliance with the statute, we conclude that the circuit court correctly dismissed Konstand's complaint for failure to state a cause of action upon which relief may be granted. Because we are affirming the dismissal of his complaint, we decline to address Konstand's arguments related to demand futility.

¶ 29 Affirmed.