

**LaSalle Bank National Association v Nomura Asset
Capital Corporation**

2005 NY Slip Op 30217(U)

October 27, 2005

Supreme Court, New York County

Docket Number: 0603339/2003

Judge: Richard B. Lowe

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SUPREME COURT OF THE STATE OF NEW YORK — NEW YORK COUNTY

PRESENT: HON. RICHARD B. LOWE, III
Justice

PART 54

LaSalle Bank National
Associations

- v -

Nomura Asset Capital

INDEX NO. 603.339/03
MOTION DATE 5/5/07
MOTION SEQ. NO. 008
MOTION CAL. NO. _____

The following papers, numbered 1 to _____ were read on this motion to/for _____

Notice of Motion/ Order to Show Cause — Affidavits — Exhibits ...
Answering Affidavits — Exhibits _____
Replying Affidavits _____

Cross-Motion: Yes No

Upon the foregoing papers, it is ordered that this motion

FILED

NOV - 7 2005
NEW YORK
COUNTY CLERK'S OFFICE

**MOTION IS DECIDED IN ACCORDANCE
WITH ACCOMPANYING MEMORANDUM DECISION**

MOTION/CASE IS RESPECTFULLY REFERRED TO JUSTICE
FOR THE FOLLOWING REASON(S):

Dated: 10/27/05

HON. RICHARD B. LOWE, III
J.S.C.

Check one: FINAL DISPOSITION NON-FINAL DISPOSITION

Check if appropriate: DO NOT POST

SUPREME COURT OF THE STATE OF NEW YORK
 COUNTY OF NEW YORK: IAS PART 56

-----X
 LASALLE BANK NATIONAL ASSOCIATION
 (f/k/a LASALLE NATIONAL BANK), as Trustee
 for the Certificateholders of ASSET SECURITIZATION
 CORPORATION COMMERCIAL MORTGAGE
 PASS-THROUGH CERTIFICATES SERIES 1997-D5,

Index No. 603339/03

Plaintiff,

-against-

NOMURA ASSET CAPITAL CORPORATION
 and ASSET SECURITIZATION CORPORATION,

Defendants.
 -----X

Richard B. Lowe, III, J.:

Plaintiff LaSalle Bank National Association (LaSalle), as Trustee for the Certificateholders of Asset Securitization Corporation Commercial Mortgage Pass-Through Certificates Series 1997-D5 (Trust), brings this action against defendants Nomura Asset Capital Corporation (Nomura) and Asset Securitization Corporation (ASC) for breach of several representations and warranties made to LaSalle in connection with the sale and securitization of a pool of 155 commercial mortgage loans (totaling approximately \$1.8 billion). In motion sequence number 008, defendants Nomura and ASC move, pursuant to CPLR 3212, for summary judgment to dismiss the complaint in its entirety. In motion sequence number 009, plaintiff LaSalle moves, pursuant to CPLR 3212, for partial summary judgment on Counts I and III of the complaint with respect to four particular mortgage loans.

BACKGROUND

The underlying facts of this action are discussed in greater detail in this court's decision for motion sequence number 001, dated March 23, 2004. On October 24, 1997, pursuant to a

“Mortgage Loan Purchase and Sale Agreement” (MLPSA), Nomura assembled and sold the pool of 155 commercial mortgage loans to its affiliate, ASC. See Amianna Stovall Affirmation in Support (Stovall Affirmation), Ex. 3. On the same date, pursuant to a “Pooling and Servicing Agreement” (PSA) between ASC, LaSalle, and several other entities, ASC deposited the mortgage loans into the above-mentioned Trust. See Stovall Affirmation, Ex. 2. ORIX Capital Markets, L.L.C. (ORIX) is the successor-in-interest of the Special Servicer under the PSA, and is obligated to service mortgage loans that are in default or imminent danger of being in default. In the MLPSA, Nomura provides certain representations and warranties to ASC concerning the mortgage loans sold, and acknowledges ASC’s assignment of those loans and the accompanying representations and warranties to LaSalle, as Trustee. In the PSA, ASC assigns the mortgage loans to LaSalle, as Trustee, and confirms in section 2.03 (b) (v) that all of Nomura’s representations and warranties made in the MLPSA were true and correct as of October 24, 1997.

Present Action

On October 23, 2003, LaSalle brought this action as Trustee. See Stovall Affirmation, Ex. 1. In Count I, LaSalle asserts that Nomura breached several representations and warranties in the MLPSA. In Count II, LaSalle argues that defendants breached their obligations in the MLPSA and PSA by failing to create, maintain and/or deliver (i) complete mortgage files, and (ii) all other underlying origination and underwriting documents or files that relate to the Trust. In Count III, LaSalle maintains that ASC breached representations and warranties in the PSA, assuring the truth and accuracy of Nomura’s representations in the MLPSA.

Prior Motion to Dismiss

In motion sequence number 001, defendants moved to dismiss the complaint, pursuant to

CPLR 3013, 3211 (a) (1), and 3211 (a) (7), based on a failure to allege claims with requisite particularity, defenses arising from documentary evidence, and a failure to state a cause of action. In a decision, dated March 23, 2004, this court granted the motion to the extent of dismissing Counts I and III with respect to 145 mortgage loans that were not specified in the complaint, and denied the motion as to Count II because whether LaSalle reasonably requested the origination and underwriting files, pursuant to MLPSA ¶ 1, remained an issue of fact (March 23, 2004 Decision). MLPSA ¶ 1 specifically directed Nomura to deliver to the Trustee "all documents, instruments and agreements required to be delivered by [ASC] to the Custodian on behalf of the Trustee under the [PSA] and such other documents, instruments and agreements as [ASC] or the Trustee shall reasonably request." As a result of the March 23, 2004 Decision, the 10 mortgage loans remaining in this action were:

- (1) Super Kmart-San Antonia (Loan #37) = alleged exposure/loss of \$10,689,589.00;
- (2) Builders Square-Daytona (Loan #42) = alleged exposure/loss of \$10,210,198.00;
- (3) Builders Square-El Paso (Loan #47) = alleged exposure/loss of \$5,807,086.00;
- (4) Builders Square-San Antonio (Loan #50) = alleged exposure/loss of \$6,130,997.00;
- (5) Lancers Center (Loan #64) = alleged exposure/loss of \$5,879,978.00;
- (6) Banzhoff Mobile Home Park (Loan #105) = alleged exposure/loss of \$3,838,974.00;
- (7) San Jacinto Plaza (Loan #107) = alleged exposure/loss of \$2,897,854.00;
- (8) Best Western-Old Hickory Inn (Loan #120) = alleged exposure/loss of \$2,525,162.00;
- (9) Knights Inn-Bridgeville (Loan #138) = alleged exposure/loss of \$1,410,746.00; and
- (10) Los Arcos Apartments (Loan #154) = alleged exposure/loss of \$747,678.00.

Defendants' Summary Judgment Motion

In motion sequence number 008, defendants move, pursuant to CPLR 3212, for summary judgment to dismiss the complaint in its entirety. Defendants allege that Counts I and III should be dismissed because: (1) LaSalle failed to give prompt notice of the alleged breaches as required by the PSA; (2) at the time of securitization, defendants disclosed the very facts that now

allegedly render the loans imprudent; and (3) the underwriting of the loans was consistent with customary industry practice.

The relevant sections of the MLPSA include sections 2 (b) (x), (xix), (xxiv), (xlv), (xlvi), and (xxxvii). Section 2 (b) (x) represents that:

[Nomura] has no knowledge that the representations and warranties made by each related Borrower in such Mortgage Loan are not true in any material respect.

Section 2 (b) (xix) provides an "origination" or "underwriting" warranty that:

(A) With respect to each Mortgage Loan originated by [Nomura], no fraudulent acts were committed by [Nomura] during the origination process of such Mortgage Loan and the origination, servicing and collection of each Mortgage Loan is in all respects legal, proper and prudent in accordance with customary industry standards and (B) with respect to each Mortgage Loan originated by Bloomfield, CSFB or Bostonia, to the best of the [Nomura's] knowledge [the same]

Section 2 (b) (xxiv) states that:

There is no default, breach, violation . . . existing under the related Mortgage . . . and, to [Nomura's] knowledge, no event which, with the passage of time or with notice and the expiration of any grace or cure period, would and does constitute a default, breach, violation or event of acceleration.

Section 2 (b) (xlv) represents that:

Each Mortgaged Property . . . (ii) is served by public utilities, water and sewer (or septic facilities)

Section 2 (b) (xlvi) provides that:

[Nomura] has not advanced additional funds for principal and interest or taxes and insurance (other than holdbacks at the closing for the related Mortgage Loan from the proceeds of such loan).

Section 2 (b) (xxxvii) states that:

[N]either [Nomura] nor any affiliate thereof has any obligation or right to make any capital contribution to any Borrower under a Mortgage Loan, other than

contributions made on or prior to the Closing Date.

The relevant sections of the PSA include sections 2.01, 2.03 (e), and 2.03 (b) (v). Section 2.01 specifically provides that:

The Servicer, Special Servicer or the Trustee shall notify [Nomura] and [ASC] upon such party's becoming aware of any breach of the representations and warranties contained in this Agreement or the [MLPSA] that gives rise to a cure or repurchase obligation; *provided*, that the failure of the Servicer, the Special Servicer or Trustee to give such notification shall not constitute a waiver of any cure or repurchase obligation.

Section 2.03 (e), the "notice and cure" provision, states that the Trustee shall give prompt notice to ASC upon discovery of any breach of representations and warranties in the MLPSA with respect to any mortgage loan, or that any document required to be included in the Mortgage File failed to conform to the requirements of Section 2.01. Pursuant to section 2.03 (e), upon such notice, ASC is obligated to cure the breach or repurchase the mortgage loan within 90 days of receiving notice of the breach. As stated above, section 2.03 (b) (v) contains ASC's warrant with respect to each Mortgage Loan that all of the representations and warranties of Nomura contained in the MLPSA were true and correct as of October 24, 1997.

The defendants allege that Count II should be dismissed because: (1) the origination and underwriting documents belatedly requested were unreasonable and wholly unnecessary to the servicing or special servicing of the loans; (2) no damages resulted from defendants' alleged failure to produce such documents; and (3) defendants have produced all of their existing loan origination and underwriting files for 36 mortgage loans, including (i) each loan identified in the complaint, (ii) each loan randomly selected by the Special Master, and identified in a discovery stipulation, and (iii) each loan identified in a written demand by ORIX, dated July 7, 2003.

Defendants also assert that certain documents allegedly maintained in the sub-basement of Two World Trade Financial Center were destroyed as a result of the September 11, 2001 terrorist attacks, and cannot be produced.

It is undisputed that LaSalle no longer pursues any claims with respect to: San Jacinto Plaza (Loan #107), Knights Inn-Bridgeville (Loan #138); and Los Arcos Apartments (Loan #154). See Plaintiff's Supplemental Responses to Defendants' Second Set of Interrogatories (Plaintiff's Supplemental Responses), at 29; Defendants' Memorandum of Law in Support, at 2 n 4. Therefore, the seven mortgage loans remaining in the action are: Super Kmart-San Antonia (Loan #37); Builders Square-Daytona (Loan #42); Builders Square-El Paso (Loan #47); Builders Square-San Antonio (Loan #50); Lancers Center (Loan #64); Banzhoff Mobile Home Park (Loan #105); and Best Western-Old Hickory Inn (Loan #120).

Plaintiff's Partial Summary Judgment Motion

In motion sequence number 009, LaSalle moves, pursuant to CPLR 3212, for partial summary judgment on Counts I and III with respect to four of the above mortgage loans secured by credit leases: Super Kmart-San Antonia (Loan #37); Builders Square-Daytona (Loan #42); Builders Square-El Paso (Loan #47); and Builders Square-San Antonio (Loan #50) (collectively, Credit Lease Loans). LaSalle asserts that defendants breached the representation in MLPSA § 2 (b) (xli) because Kmart, the credit tenant, terminated the leases securing the Credit Lease Loans during its Chapter 11 bankruptcy. MLPSA § 2 (b) (xli) specifically provides that:

With respect to each Mortgage Loan secured by a Credit Lease: . . . (F) The Tenant cannot terminate the Credit Lease for any reason, prior to payment in full of or the payment of funds sufficient to pay in full: (a) the principal balance of the loan; (b) all accrued and unpaid interest on the loan; and (c) any other sums due and payable under the loan, as of the termination date, except for a default by the Landlord under

the Credit Lease[.]

The relevant facts underlying Kmart's bankruptcy are as follows. Kmart was the tenant on the lease securing Super Kmart-San Antonio (Loan #37), and the guarantor/subsequent lessee on the leases securing Builders Square-Daytona (Loan #42), Builders Square-El Paso (Loan #47), and Builders Square-San Antonio (Loan #50). The underlying leases afforded the landlord the option to terminate if the tenant filed for bankruptcy, but not the tenant. See Michael F. Wurst Affidavit in Support (Wurst Affidavit), Ex. 3, at 12, Ex. 4, at 13, Ex. 5, at 14, Ex. 6, at 12. On January 22, 2002, Kmart filed a voluntary petition for Chapter 11 bankruptcy protection. That same day, it sought authority to reject 475 unexpired commercial real property leases, and approval of procedures for rejecting 149 others.

On January 25, 2002, the United States Bankruptcy Court for the Northern District of Illinois (Kmart Bankruptcy Court) authorized Kmart to reject the credit leases securing Builders Square-Daytona (Loan # 42), Builders Square-El Paso (Loan #47), and Builders Square-San Antonio (Loan #50). The following month, Kmart sent notices to the affected borrowers/landlords, confirming its rejection of the leases, tendering possession of the premises to the landlords, and canceling all utility services to the premises. On March 26, 2003, the same court entered an order authorizing Kmart to reject the unexpired lease securing Super Kmart-San Antonio (Loan #37), stating that:

The landlord for each Real Property Lease shall be entitled to immediate possession of the premises as of the Rejection Date, subject to applicable state law. The rejection of any Real Property Lease shall have the effect of a termination and the rejection may be in the form of a termination agreement, provided the economic impact of such termination on the Debtors is at least as favorable as a rejection. This Order shall apply only to the rejection of Real Property Leases and shall not affect the obligations of the Debtors under any guaranty.

Wurst Affidavit, Ex. 14, at 2. Kmart sent a notice of rejection, dated April 17, 2003, for the last credit lease securing SuperKmart-San Antonio (Loan #37). On November 20, 2003, the Kmart Bankruptcy Court allowed the Trustee to file damages under Bankruptcy Code § 502 (b) (6), which caps damages for the termination of a lease. The Kmart Bankruptcy Court stated that:

The right to assert general unsecured claims . . . with respect to the lease (or guaranty thereof) of each property listed . . . is held exclusively by the REMIC Trustee (or ORIX or Lend Lease on behalf of the REMIC Trustee) These claims may include, but are not limited to, damages arising from the termination of the lease of each property . . . , or the breach of any guaranties with respect to such lease

Wurst Affidavit, Ex. 20, at 4.

In opposition to the motion for partial summary judgment, defendants argue that MLPSA § 2 (b) (xli) (F) must be read in conjunction with other provisions of the MLPSA and the PSA. Defendants refer to MLPSA §§ 2 (a) (iii), (b) (iv), (b) (vi), and PSA § 2.03 (a). MLPSA § 2 (a) provides that:

The Seller hereby represents and warrants to the Company as of the Closing Date that: . . . (iii) . . . this Agreement and all of the obligations of the Seller hereunder are the legal, valid and binding obligations of the Seller, enforceable in accordance with the terms of the Agreement, except as such enforcement may be limited by bankruptcy, insolvency, reorganization, liquidation, receivership, moratorium or other laws relating to or affecting creditors' rights generally, or by general principles of equity (regardless of whether such enforceability is considered in a proceeding in equity or at law).

MLPSA § 2 (b) provides that:

The Seller hereby represents and warrants with respect to each Mortgage Loan that . . . (iv) Each related Note, Mortgage, Assignment of Leases and Rents (if any) and other agreement executed in connection with such Mortgage Loan are legal, valid and binding obligations of the related Borrower, enforceable in accordance with their terms, except as such enforcement may be limited by bankruptcy, insolvency, reorganization, moratorium or other laws affecting the enforcement of creditors' rights generally, or by general principles of equity (regardless of whether such

enforceability is considered in a proceeding in equity or at law) . . . (vi) Each related assignment of Mortgage from the Seller to the Company and any related Reassignment of Assignment of Leases and Rents, if any, or assignment of any other agreement executed in connection with such Mortgage Loan, from the Seller to the Company constitutes the [same]

PSA § 2.03 (a) states that:

The Depositor hereby represents and warrants that: . . . (iii) . . . this Agreement and all of the obligations of the Depositor hereunder are the legal, valid and binding obligations of the Depositor, enforceable in accordance with the terms of this Agreement, except as such enforcement may be limited by bankruptcy, insolvency, reorganization, liquidation, receivership, moratorium or other laws relating to or affecting creditors' rights generally, or by general principles of equity (regardless of whether such enforceability is considered in a proceeding in equity or at law)

Defendants contend that, when read in conjunction with the above provisions, it is clear that MLPSA § 2 (b) (xli) (F) is limited by operation of the Bankruptcy Code.

DISCUSSION

The party seeking summary judgment must demonstrate that it is entitled to judgment as a matter of law by demonstrating that no material issue of fact remains requiring trial. See Winegrad v New York Univ. Med. Ctr., 64 NY2d 851, 853 (1985). When the court is asked to interpret a contract that is "straightforward and unambiguous, its interpretation presents a question of law for the court to be made without resort to extrinsic evidence." Ruttenberg v Davidge Data Sys. Corp., 215 AD2d 191, 192-93 (1st Dept 1995). When a contract's meaning is "ambiguous and the intent of the parties becomes a matter of inquiry, a question of fact is presented which cannot be resolved on a motion for summary judgment." Id. (citation omitted).

Defendants' Summary Judgment Motion

Defendants' summary judgment motion is denied. Defendants maintain that they have demonstrated a prima facie entitlement to judgment as a matter of law to dismiss Counts I and III

because: (1) LaSalle and ORIX failed to give them prompt notice of the alleged breaches as required by the PSA; (2) Nomura fully disclosed, at the time of securitization in October 1997, the very facts that ORIX now alleges render the loans imprudent; and (3) the underwriting of the loans was consistent with customary industry practice. The defendants contend that, as a matter of law, Count II should be dismissed because: (1) the requested origination and underwriting documents are wholly unnecessary to the servicing or special servicing of the loans; (2) no damages resulted from defendants' alleged failure to produce; and (3) defendants have produced all of their existing loan origination and underwriting files for 36 mortgage loans, including the subject 7 mortgage loans.

Failure to Give Prompt Notice

Defendants' argument that LaSalle waived its rights under these agreements by failing to provide adequate notice is without merit. Defendants fail to show that the prompt notice required in PSA § 2.03 (e) was "an express condition precedent" to bringing a suit, rather than "a promise," and that the parties used "the unmistakable language of conditions ('if,' 'unless and until')." Oppenheimer & Co., Inc. v Oppenheim, Appel, Dixon & Co., 86 NY2d 685, 691 (1995). In fact, PSA § 2.01 clearly states that failure to give notice does not constitute a waiver of defendants' obligations to cure or repurchase. The court finds that the PSA should be construed so as to give full effect to all of its provisions, and refuses to interpret the PSA to render section 2.01 meaningless. See Shaw Group, Inc. v Triplefine Intl. Corp., 322 F3d 115, 121, 124 (2d Cir 2003).

Alleged Disclosure

Defendants fail to demonstrate as a matter of law that their purported disclosures in the Prospectus, and Prospectus Supplement, and during negotiations of the price of the certificates,

preclude LaSalle's claim for breach of the express underwriting representation contained in MLPSA § 2 (b) (xix). New York law is clear that in order to conclude that LaSalle has waived its right to assert a claim for breach of warranty, the court must find that, prior to closing, defendants themselves actively disclosed to plaintiffs facts which would constitute a breach of warranty under the terms of the MLPSA and the PSA. See Morgan Guar. Trust Co. of New York v Bay View Franchise Mtge. Acceptance Co., 2002 US Dist LEXIS 7572, at *43 (SD NY 2002) (citing New York law) ("Whether a buyer closes 'in the full knowledge and acceptance of facts disclosed by the seller' depends on 'fine factual distinctions' involving 'both the extent and the source of the buyer's knowledge about the truth of what the seller is warranting'"). Triable issues remain regarding defendants' disclosure and LaSalle's knowledge of defendants' failure to comply with the representations and warranties of the MLPSA and the PSA. For example, questions of fact remain regarding whether, at the time of securitization, the Trustee was actually aware of the information allegedly disclosed, and the value of the facts defendants disclosed.

Underwriting and Origination of Loans

Before analyzing defendants' arguments for summary judgment with respect to the underwriting warranty, pursuant to MLPSA § 2 (b) (xix), and PSA § 2.03, the court first addresses defendants' allegation that LaSalle improperly raises new contentions in its Supplemental Response, and expert reports. LaSalle asserts for the first time: (1) in its Supplemental Response, that defendants breached the underwriting warranty as to the Credit Lease Loans because Kmart was not a proper Credit Tenant by reason of its BB- rating; (2) in its expert report, that defendants breached the underwriting representation as to the Credit Lease Loans because Builders Square was not "integral" to Kmart's business; (3) in its Supplemental Response, that Nomura breached

the underwriting representation as to the Lancers Center Loan because Nomura failed to obtain a “warm body” guarantee; (4) in its Supplemental Response, that Nomura breached (i) the underwriting representation as to the Banzhoff Mobile Home Parks Loan because it used a vacancy rate of 6% for the Shawnee/Sciota mobile home park, while the actual vacancy rate was higher, and (ii) the representation in MLPSA § 2 (b) (xiv) that each mortgaged property “is served by public utilities, water and sewer (or septic facilities),” because two of the other parks used well water and had septic systems; (5) in its expert report, that Nomura breached (i) the underwriting representation as to the Banzhoff Mobile Home Parks Loan because the loan failed to meet the mobile home park criteria in a separate purchase agreement known as “The Bloomfield Purchase Agreement,” (ii) the underwriting representation because it failed to acquire an upfront holdback for the repairs for the Shawnee/Sciota mobile home park, and (iii) the representation and warranty in MLPSA § 2 (b) (xxiv) that there is no default under the related Mortgage or the related Note because Nomura knew that borrower would implement the engineer’s recommendations; (6) in its expert reports, that defendants breached the underwriting representation as to the Best Western-Old Hickory Inn Loan because (i) the borrower took on additional debt in breach of the Mortgage and related Note, (ii) the borrower failed to fund the replacement reserve, (iii) Nomura failed to require a seasonality reserve, and (iv) Nomura failed to use the appraiser’s occupancy estimations in forecasting the negative operating income. LaSalle claims that leave to amend the complaint to add the new contentions is not necessary because the complaint specified which loans breached which representations and warranties, and that there is no requirement that a complaint in a contract action specify the exact manner in which each breach took place. LaSalle asserts that, if an amendment to the complaint is necessary, the court should permit such amendment pursuant to

CPLR 3025.

“The general policy of courts is to permit amendments before trial where no prejudice will result. However, where there has been a long delay and a statement of readiness has been filed, judicial discretion in allowing amendments should be ‘discreet, circumspect, prudent and cautious.’” Symphonic Elec. Corp. v Audio Devices, Inc., 24 AD2d 746 (1st Dept 1965) (internal citations omitted). Leave to amend, pursuant to CPLR 3025 (b), “rests in the sound discretion of the court.” Birdsall v City of New York, 60 AD2d 522 (1st Dept 1977). “In exercising its discretion, the court should consider how long the amending party was aware of the facts upon which the motion was predicated, whether a reasonable excuse for the delay was offered, and whether prejudice resulted therefrom.” Sidor v Zuhoski, 257 AD2d 564 (2d Dept 1999).

The court finds that a claim sounding in breach of express warranty requires the plaintiff to set forth the terms of the warranty upon which it relies. See Davis v New York City Hous. Auth., 246 AD2d 575, 576 (2d Dept 1998). Therefore, the court refuses to entertain any of the above contentions asserted by LaSalle, relating to the newly raised representations and warranties contained in MLPSA §§ 2 (b) (xlv), and (xxiv). LaSalle offers no reasonable excuse for the delay, and permitting these new contentions at this late stage in the litigation (where a statement of readiness has been filed) would prejudice the defendants. The court, however, finds that the complaint sufficiently asserts a cause of action for breach of the underwriting warranty, and considers the above related contentions in its analysis below.

In support of its summary judgment motion to dismiss, defendants argue that there is no basis to find that the underwriting of the mortgage loans is inconsistent with customary industry standards, and that the alleged breach of the representations and warranties in MLPSA § 2 (b)

(xix), and PSA § 2.03 (b) (v), must be dismissed. Defendants submit an expert report by Teresa F.

Esquivel (Esquivel), a securitization expert, which specifically attests that:

Having reviewed copies of the file with respect to certain of the loans in the D5 Securitization, as well as other documents, it is my opinion that [Nomura's] underwriting procedures were consistent with the CMBS industry's loan underwriting practices as outlined above and that [Nomura's] procedures were uniform and thorough.

[Standard & Poor's (S&P)] confirms this assessment with the statement in its presale report . . . that : "The underwriting follows a consistent set of policies and procedures resulting in a 3% variance from Standard & Poor's cash flow" (a 3% variance is a minor haircut - industry wide haircuts tend to range from 5 to 10%). Similarly, in its report on the D5 Securitization . . . , Fitch described [Nomura's] underwriting procedures as "very good." . . .

With respect to . . . the Best Western - Old Hickory Inn Loan, the Banzhoff Mobile Home Park Loan, the Lancers Center Loan, and the Builders Square Credit Lease Loans, it is my opinion, as detailed below, that [Nomura's] origination and underwriting was proper and prudent in accordance with customary industry standards.

Expert Report of Teresa F. Esquivel, dated January 21, 2005 (Esquivel Report), at 14. In opposition, LaSalle provides several expert reports, including the Expert Report of Ronald F. Greenspan, an underwriting and securitization expert, dated December 16, 2004 (Greenspan Report), and the Rebuttal Expert Report of Ronald F. Greenspan dated February 14, 2005 (Greenspan Rebuttal Report), which contradict the statements made by Esquivel.

With respect to the Credit Lease Loans, the parties' experts disagree on: (1) whether the loan-to-value (LTV) ratio was too high; (2) whether the guarantor had a proper credit rating; (3) whether Kmart's guarantee of the Builders Square Leases was in accordance with industry standards; (4) whether Kmart was a proper Credit Tenant by reason of its BB- rating; and (5) whether Kmart made a strategic decision to exit the Builders Square business, and whether the

Builders Square leases were an “integral” part of the core business of Kmart.

With respect to the Lancers Center Loan, the parties’ experts disagree on: (1) whether it was improper for the Lancers Center Lease to fail to include continuous use and non-competition clauses; (2) whether Nomura properly took account of Wal-Mart’s possible relocation; and (3) whether Nomura improperly failed to obtain a “warm body” guarantee.

With respect to the Banzhoff Mobile Home Parks Loan, the parties’ experts disagree on: (1) whether the LTV percentage was too high; (2) which vacancy rate for the Shawnee/Sciota mobile home park should have been used; (3) whether the loan failed to meet the mobile home park criteria in the Bloomfield Purchase Agreement mentioned above; and (4) whether the loan failed to acquire an upfront holdback for potential repairs to the Shawnee/Sciota mobile home park.

With respect to the Best Western-Old Hickory Inn, the parties’ experts disagree on: (1) whether Nomura acted properly by providing the borrower with an additional \$450,000.00 mezzanine debt; (2) whether the mortgage loan, when combined with the mezzanine loan resulted in a LTV of 90% that was too high; (3) whether the combination also placed stress on the cash flow, resulting in a 1.05 debt service coverage ratio (DSCR) that was too low; (4) whether Nomura improperly disregarded the fact that the borrower and manager did not have sufficient operating experience; (5) whether Nomura improperly disregarded the fact that the principal of the borrower, Fahmi Abbo Yousif (Yousif), did not have sufficient equity invested in the property; (6) whether the borrower improperly failed to fund the replacement reserve; and (7) whether Nomura improperly failed to use the appraiser’s occupancy estimations in forecasting the negative operating income.

Defendants’ motion for summary judgment to dismiss Counts I and III based on their

arguments under the underwriting warranty is denied because the conflicting reports of the parties' respective experts raise triable issues regarding whether Nomura's origination and underwriting of the seven remaining mortgage loans violate customary lending practices in the commercial mortgage-backed securities (CMBS) industry. See Rodriguez v Pelham Plumbing & Heating Corp., 20 AD3d 314, 315 (1st Dept 2005) (denying motion for summary judgment "since the conflicting affidavits of the parties' respective engineering experts raise triable issues"); Pascual v Kingsley Realty Holdings, Ltd., 8 AD3d 26 (1st Dept 2004) (denying the parties' respective motions for summary judgment). Given the above, triable issues also remain regarding ASC's alleged breach of PSA § 2.03 (b) (v), in which it provides assurances regarding the nature of the loans and the truth and accuracy of Nomura's representations in the MLPSA.

Request for Loan Origination and Underwriting Files

As for Count II, LaSalle's submission of an affidavit by Michael F. Wurst (Wurst), the Director of Distressed and Proprietary Assets, Real Estate Group, for ORIX, raises questions of fact regarding whether or not LaSalle's and ORIX's request for loan origination and underwriting files was "reasonable." Wurst, who worked on the special servicing of the subject loans, maintains that defendants' failure to respond to his written demands for loan origination and underwriting documents, dated July 7, 2003 and August 2, 2004, harmed the Trust and hindered ORIX's ability to perform its duties as Special Servicer. Wurst contends that having origination and underwriting documents, such as borrower loan applications, personal financial statements, personal and entity income tax returns, property condition data and assessments, operating data for years prior to the funding of the loans, entity organization documents and evidence of negotiations pertaining thereto, and the analysis and conclusions undertaken and reached by defendants and/or their

correspondent loan originators, would have allowed ORIX to expedite resolution of problems before they occurred, reduced costs to the Trust, and informed LaSalle and ORIX when breaches of representations and warranties contained in the loan documents occurred. Defendants' deposition testimony, which allegedly shows that each Servicer or Special Servicer responsible for the Mortgage Loans before ORIX was capable of servicing the loans without the additional documents requested by ORIX, fails to eliminate the issues of fact raised by Wurst. In addition, defendants' assertion that they have now produced all of their existing loan origination and underwriting files does not eliminate the issue of whether the delay in production, or the missing documents, somehow damaged the Trust. Furthermore, issues of fact also remain regarding how to ascertain the damages that the Trust has allegedly suffered.

LaSalle's Partial Summary Judgment Motion

LaSalle's partial summary judgment motion as to Counts I and III with respect to the Credit Lease Loans is denied. LaSalle asserts that defendants breached the representation in MLPSA § 2 (b) (xli) (F) because Kmart, the credit tenant, improperly terminated the leases securing the Credit Lease Loans during its Chapter 11 bankruptcy. As stated above, MLPSA § 2 (b) (xli) specifically provides that:

With respect to each Mortgage Loan secured by a Credit Lease: . . . (F) The Tenant cannot terminate the Credit Lease for any reason, prior to payment in full of or the payment of funds sufficient to pay in full: (a) the principal balance of the loan; (b) all accrued and unpaid interest on the loan; and (c) any other sums due and payable under the loan, as of the termination date, except for a default by the Landlord under the Credit Lease[.]

In opposition, defendants argue that Kmart's rejection of the leases, pursuant to Bankruptcy Code § 365 (g), resulted in a "breach," rather than a "termination," and that MLPSA § 2 (b) (xli) (F) must

be read in conjunction with other provisions of the MLPSA and the PSA.

Pursuant to Bankruptcy Code § 365 (g), the trustee or debtor-in-possession, subject to court approval, may reject any unexpired lease of the debtor. While it is undisputed that the lease is deemed rejected and breached, the effect of such a rejection and breach remains unclear. Bankruptcy courts have differed on this issue. One court ventured to state that “[t]he effect of rejection is one of the great mysteries of bankruptcy law.” In re Henderson, 245 BR 449, 453 (SD NY Bankr 2000). Unlike leases of residential property where the rejection has the effect of abandoning the lease back to the debtor, a bankruptcy court may authorize rejection of the unexpired lease for commercial property, order the debtor to surrender the premises, and treat the lease as “terminated” as analogous to Bankruptcy Code § 365 (d) (4). See Sierra Vista Assocs. v Kmart Corp. (In re Kmart), 2003 US Dist LEXIS 23286, at **20-24 (ND Ill 2003) (“Whether the lease is terminated will depend on the particular circumstances, but ordinarily, if the property is surrendered, the lease should be terminated”); 3 Collier on Bankruptcy (Lawrence P. King, *et al.* eds., 15th ed. 1996) (Collier on Bankruptcy) § 365.09; In re 6177 Realty Assoc., Inc., 142 BR 1017, 1019 (Bankr SD Fla 1992) (“Rejection of a non-residential lease results in termination of the lease. Once the underlying lease is terminated, leasehold mortgagees or sublessees retain no interest that can be pursued in bankruptcy court or state court”). Courts have interpreted section 365 (d) (4), which provides that if the Trustee does not assume an unexpired lease within 60 days of the filing date, then such lease is rejected and the Trustee “shall immediately surrender such non-residential real property to the lessor” as terminating the lease by operation of law. See In re 6177 Realty Assoc., Inc., 142 BR at 1019; In re Giles Assoc. Ltd., 92 BR 695, 696 (Bankr WD Tex 1988). Other courts find that a mere breach occurs, and that the lease itself survives. See In re Tri-

Glied, Ltd., 179 BR 1014, 1022 (Bankr ED NY 1995); Collier on Bankruptcy § 354.09.

The decision of “[w]hether to require surrender and whether to treat the lease as terminated would be within the discretion of the Bankruptcy Court depending on the particular facts and circumstances of the lease.” In re Kmart, 2003 US Dist LEXIS 23286, at **23-24. It appears to be uncontroverted that: (1) Kmart issued notices of surrender (see Wurst Affidavit, Exs. 12, 13, 15); (2) Kmart vacated the premises; (3) Kmart tendered possession of the premises to the landlord; (4) Kmart canceled all utility services to the premises (see id.); and (5) Kmart turned over the keys to the landlord (see Mishell B. Kneeland Affirmation in Support [Kneeland Affirmation], Ex. 3, at 74-75, 79, 117). Based on the language of the Kmart Bankruptcy Court Orders, dated March 26, 2003 and November 20, 2003, it appears that the Kmart Bankruptcy Court held that the rejection of the unexpired leases, and the immediate surrender of the properties to the lessor, resulted in a complete termination of the leases.

The court, however, refuses to grant LaSalle’s motion for partial summary judgment because the record and the above mentioned Kmart Bankruptcy Court Orders show that the four leases at issue were terminated through the acts of both Kmart and the Kmart Bankruptcy Court. Whether the parties intended MLPSA § 2 (b) (xli) (F) to apply to such circumstances, or to only apply to terminations by a tenant’s unilateral act remains an issue of fact. In addition, questions of fact remain regarding whose “bankruptcy” the parties refer to in MLPSA §§ 2 (a) (iii), (b) (iv), and (b) (vi), and PSA §§ 2.03 (a) (iii), 2.04 (b) (iii). These sections do not expressly state whether the term “bankruptcy” refers to the Seller’s or Depositor’s own bankruptcy, rather than bankruptcy laws in general, and are reasonably capable of more than one meaning.

Accordingly, it is


ORDERED that defendants' motion for summary judgment, pursuant to CPLR 3212, is granted, to the extent of dismissing all claims with respect to the mortgage loans known as San Jacinto Plaza (Loan #107), Knights Inn-Bridgeville (Loan #138); and Los Arcos Apartments (Loan #154), and is otherwise denied; and it is further

ORDERED that the plaintiff's motion for partial summary judgment, pursuant to CPLR 3212, is denied; and it is further

ORDERED that the remainder of the action shall continue.

Dated: New York, New York
October 27, 2005

ENTER:


HON. RICHARD B. LOWE, III
J.S.C.

FILED
NOV -7 2005
NEW YORK
COUNTY CLERK'S OFFICE