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

PRESENT: HON. EILEEN BRANSTEN PART 3
Justice

Index Number : 651587/2012
RREEF STRUCTURED DEBT FUND
vs.
TALMAGE, LLC
SEQUENCE NUMBER : 001
DISMISS ACTION

INDEX NO. 651587/12
MOTION DATE 11/30/13
MOTION SEQ. NO. 001

The following papers, numbered 1 to 3, were read on this motion to/for dismiss

Notice of Motion/Order to Show Cause — Affidavits — Exhibits No(s). 1
Answering Affidavits — Exhibits No(s). 2
Replying Affidavits No(s). 3

Upon the foregoing papers, it is ordered that this motion is

IS DECIDED

IN ACCORDANCE WITH ACCOMPANYING MEMORANDUM DECISION

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

Dated: 7-8-13

Eileen Branston, J.S.C.
HON. EILEEN BRANSTEN

1. CHECK ONE: ..... ☒ CASE DISPOSED ☐ NON-FINAL DISPOSITION
2. CHECK AS APPROPRIATE: .....MOTION IS: ☒ GRANTED ☐ DENIED ☐ GRANTED IN PART ☐ OTHER
3. CHECK IF APPROPRIATE: ..... ☐ SETTLE ORDER ☐ SUBMIT ORDER
☐ DO NOT POST ☐ FIDUCIARY APPOINTMENT ☐ REFERENCE

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

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RREEF STRUCTURED DEBT FUND INVESTMENTS, INC.,

Plaintiff,

-against-

TALMAGE, LLC,

Defendant.

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Index No.: 651587/12
Motion Date: 01/30/12
Motion Seq. No.: 001

BRANSTEN, J.

In motion sequence number 001, Defendant Talmage, LLC ("Defendant" or "Special Servicer") moves pursuant to CPLR 3211(a)(1) and (a)(7) to dismiss Plaintiff RREEF Structured Debt Fund Investments, Inc.'s ("Plaintiff" or "RREEF") Complaint (the "Complaint") in this action. Plaintiff opposes.

## I. Background[1]

On May 9, 2007, JPMorgan ("JPMorgan" or the "Senior Participant"), as the lender, entered into a loan agreement with a number of borrowers in the original principal amount of $510 million (the "Loan"). (Compl. ¶ 9.) The Loan is secured by a first mortgage lien on a portfolio of hotel properties. *Id.*

A number of parties, including RREEF, purchased an interest in the Loan. The respective rights, remedies and obligations of RREEF and the other participants in the Loan

[1] Unless otherwise stated, the facts in this section are drawn from Plaintiff's Complaint ("Complaint" or "Compl.").

(the "Participants") are governed by the Participation Agreement dated June 29, 2007 (the "Participation Agreement"). *Id.* at ¶ 14. Under the Participation Agreement the Loan was divided into seven participation interests constituting participations A through G (holders of the participation interests hereinafter "Participant A" through "Participant G" respectively). *Id.* RREEF purchased the most junior participation interest in the Loan, the participation G interest, in the original principal amount of $25 million. *Id.* at ¶ 15. JPMorgan, as Senior Participant, retained the senior-most participation interest in the Loan and securitized the participation interests pursuant to a pooling and servicing agreement dated August 1, 2007 (the "PSA").[2] *Id.* The PSA sets out the rights of the various Participants, including RREEF, with respect to the servicing of the loan, and the Participation Agreement and PSA are intended to work in tandem. *Id.* at ¶¶ 17-18.

Pursuant to the PSA, a "Special Servicer" is to be appointed under certain circumstances, including when "a material default under the [Loan] . . . has occurred or is imminent." (Affirmation of H. Seiji Newman in Support of Defendant's Motion to Dismiss ("Newman Affirm."), Ex. 2 ("PSA") at p. 78.)

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[2] The other participations are believed by Plaintiff to be held by the following entities and/or their affiliates: Fillmore Real Estate (Participation B and D Interests); Five Mile Capital Partners LLC (Participation E Interest); and Rialto Capital Management LLC ("Rialto") (Participation F Interest). The Participation C Interest was never issued. (Compl. ¶ 16.)

***A. Appointment of the Special Servicer***

On or about February 1, 2012, Talmage was appointed as Special Servicer of the Loan on the grounds that a material default under the Loan Agreement was imminent. (Compl. ¶ 21.)

Accordingly, the fees and expenses owed to the Special Servicer were deducted "off the top" before any distributions were made to the Participants. Because it is the most junior participant, RREEF was the most affected by these deductions, as it was paid only after Participants A through F were paid the amounts due to them under § 3 of the Participation Agreement. Once these fees were deducted "off the top" the remaining amounts available for distribution to the Participants were distributed as per the Participation Agreement § 3 waterfall, in the order of the Participants' respective seniority. RREEF, as the most junior Participant, was most impacted by the payment of the Special Servicer's fees. Because the amounts were deducted "off the top" and were not borne proportionately by each Participant, RREEF claims it has sustained damages of at least $300,000. (Compl. ¶ 40).

***B. The Participation Agreement's Payment Waterfall***

Under Participation Agreement § 3, distributions were to be made to the Participants as follows:[3]

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[3] The payments were made as follows, provided there was no "Sequential Pay Event." Neither party asserts that there was a "Sequential Pay Event" during the time of the disputed payments.

all amounts tendered by the Mortgage Loan Borrower[4] or otherwise available for payment on or with respect to or in connection with the Mortgage Loan or the Mortgaged Property or amounts realized as proceeds thereof . . . but excluding . . . (y) all amounts that are then due, payable or reimbursable to any Servicer [Master Servicer or Special Servicer as the context may require][5] . . . shall be applied by the Senior Participant (or its designee) for payment in the following order of priority . . . :

(a) first, to the Senior Participant in an amount equal to the accrued and unpaid interest on the Senior Participation Principal Balance at the Net Senior Participation Rate[6]

(b) second, to the Senior Participant in an amount equal to the Senior Participation Percentage Interest of principal payment received, if any, with respect to such Monthly Payment Date with respect to the Mortgage Loan, until the Senior Participation Principal Balance has been reduced to zero;

(c) third, to the Senior Participant up to the amount of any unreimbursed costs and expenses paid by the Senior Participant . . .

(d) fourth, to the Junior B Participant in an amount equal to the accrued and unpaid interest on the Junior B Participation Principal Balance at the Junior B Participation Rate

(e) fifth, to the Junior B Participant in an amount equal to the Junior B Participation Percentage Interest of principal payments received, if any, with respect to such Monthly

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[4] Terms not defined herein are defined in the applicable agreement.

[5] Participation Agreement § 1, p. 23.

[6] as defined below

> Payment Date with respect to the Mortgage Loan, until the Junior B Principal Balance has been reduced to zero.

Compl., Ex. B ("Participation Agreement") at § 3. The Participation Agreement continues in this fashion, through the participation interests of the junior C, D, E, F and G Participants. *See id.* at § 3(f)-(o).

With regard to the Senior Participant's interest (*see* Participation Agreement § 3(a)), the "Net Senior Participation Rate" is defined as "the Senior Participation Rate minus the sum of the Servicing Fee Rate and the Trustee Fee Rate." *Id.* at § 1, p. 17. The "Servicing Fee Rate" is defined in the PSA and is a fixed, constant percentage rate for the master servicing of each particular loan that is part of the trust. *See* PSA at p. 75; *see also* Affirmation of H. Seiji Newman in Further Support of Defendant's Motion to Dismiss, Ex. 1 ("PSA Ex. B"). This Servicing Fee Rate is not altered by the appointment of a Special Servicer on a loan.[7] (PSA Ex. B.)

The language of the Participation Agreement specifies that any amounts due and payable to the Special Servicer must be deducted from amounts otherwise distributable to the Participants pursuant to § 3. The parties herein dispute whether these Special Servicer fees should be deducted "off the top," prior to payment of any of the Participants, or if the Participants should share in these costs, and each Participant's distribution should thereby be reduced by a pro rata portion of its share of the Special Servicer's fees.

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[7] Similarly, the defined "Trustee Fee Rate" is also a flat, constant percentage that does not fluctuate when a Special Servicer has been appointed.

RREEF commenced this action on May 8, 2012, bringing causes of action in breach of contract and breach of the implied covenant of good faith and fair dealing. On June 19, 2012, Defendant brought the instant motion to dismiss RREEF's Complaint based on the terms of the agreements amongst the parties and the agreements' exculpatory clauses. Oral argument was held on December 10, 2012, and the motion was marked submitted when the Court received the transcript on January 30, 2013.

## II. Analysis

### *A. Motion to Dismiss Standard*

On a motion to dismiss for failure to state a cause of action, the court must accept each and every allegation as true and liberally construe the allegations in the light most favorable to the pleading party. *Guggenheimer v. Ginzburg*, 43 N.Y.2d 268, 275 (1977); *see* CPLR 3211(a)(7). "We . . . determine only whether the facts as alleged fit within any cognizable legal theory." *Leon v. Martinez,* 84 N.Y.2d 83, 87-88 (1994).

On the other hand, while factual allegations contained in a complaint should be accorded a favorable inference, bare legal conclusions and inherently incredible facts are not entitled to preferential consideration. *Sud v. Sud*, 211 A.D.2d 423, 424 (1st Dep't 1995).

Moreover, where the motion to dismiss is based on documentary evidence (CPLR 3211(a)(1)), the claim will be dismissed "if the documentary evidence submitted conclusively

establishes a defense to the asserted claims as a matter of law." *Leon*, 84 N.Y.2d at 88; *see also 150 Broadway N.Y. Assoc., L.P. v. Bodner*, 14 A.D.3d 1, 5 (1st Dep't 2004).

***B. Breach of Contract***

Defendant argues that the Court should dismiss Plaintiff's cause of action for breach of contract because the Participation Agreement and the PSA conclusively establish that Defendant did not breach the Participation Agreement. (Memorandum of Law in Support of Defendant's Motion to Dismiss, p. 8.) Defendant contends that Plaintiff is merely dissatisfied that, as the junior-most Participant, it was most affected by the appointment of a Special Servicer pursuant to the contract documents. *Id.* Defendant also maintains that Plaintiff's entire Complaint should be dismissed based on exculpatory clauses in both the Participation Agreement and the PSA. *Id.* at p. 12.

Plaintiff contends that Defendant breached the Participation Agreement by improperly deducting its fees and expenses solely from amounts due to Plaintiff. (Memorandum of Law of Plaintiff RREEF Structured Debt Fund Investments, Inc. in Opposition to the Motion to Dismiss the Complaint of Defendant Talmage, LLC, p. 7.) Plaintiff does not disagree that Defendant deducted the expenses "off the top" of the amounts otherwise payable as distributions to the Participants. Plaintiff argues, however, that § 3 of the Participation Agreement requires that Defendant deduct its expenses in a pro rata amount from each

Participant prior to making any distributions. *Id.* at p. 8. Plaintiff also maintains that Defendant is not protected by the exculpatory clauses in the Participation Agreement and the PSA because "Talmage may not seek protection from suit under the exculpatory provision[s] on the basis of conduct that is in flagrant disregard of its obligations[.]" *Id.* at p. 9.

Defendant's motion to dismiss Plaintiff's cause of action for breach of contract is granted because the Participation Agreement confirms that Defendant acted as it was required pursuant to the Participation Agreement.

Although Plaintiff was the most affected by the deduction of the Special Servicer's fees, Plaintiff incorrectly asserts that "Talmage has deducted 100% of its special servicing fees from the amounts otherwise validly due and owing to RREEF under Section 3 of the Participation Agreement." *See* Compl. ¶ 31.

First, Defendant did not deduct 100% of its fees from amounts otherwise due to Plaintiff. As Plaintiff acknowledges in its Complaint, Defendant deducted some of its fees from Participant F. *See id.* at ¶ 32. This is because, in April 2012, the Special Servicer's fees were large enough that the deductions made "off the top" so greatly diminished the funds available for distribution that Participant F's distributions were also affected. Indeed, in any given month, the Special Servicer's fees and expenses might be so large as to affect even more senior Participants' distributions.

Participation Agreement § 3 plainly requires that the Special Servicer's fees be deducted from amounts available for distribution to the Participants before the amounts available for distribution go through the payment waterfall. *See* Participation Agreement § 3 (stating that all amounts "otherwise available for payment" but *excluding* "all amounts that are then due and payable or reimbursable to any Servicer" which includes payments due to any Special Servicer "shall be applied by the Senior Participant (or its designee) for payment in the following order of priority"). Section 3 thus unambiguously contemplates the deduction of the Special Servicer's expenses from the total amount available for distribution prior to the distribution to Participants through the waterfall.

Plaintiff's reliance on Participation Agreement § 3(a) for its contention that all Participants must share in the cost of the Special Servicer's fees also fails. Participation Agreement § 3(a) provides that the "Senior Participant shall receive an amount equal to the accrued and unpaid interest on the Senior Participation Principal Balance at the Net Senior Participation Rate[,]" and the Net Senior Participation Rate includes a deduction for the "Servicing Fee Rate." As detailed by the Court *supra* at Part I.A, however, the "Servicing Fee Rate' is a flat percentage with regard to the costs for the master servicing of the loan. This fee rate is unrelated to the costs incurred as a result of the appointment of a Special Servicer when a material default under a loan is imminent. Thus, Participation Agreement § 3(a) does not encompass deducting the Special Servicer's fees from the Senior Participant.

The § 3 provisions relating to distributions to the other Participants similarly do not encompass a pro rata deduction of the Special Servicer's fees. In fact, no provision in either the Participation Agreement or the PSA obligates the Special Servicer to deduct its fees in a pro rata amount from each Participant. The Participation Agreement thus conclusively establishes that Defendant acted in accordance therewith by deducting the Special Servicer's fees "off the top," and therefore did not breach the Participation Agreement. *See Leon*, 84 N.Y.2d at 88.

Accordingly, Defendant's motion to dismiss Plaintiff's cause of action for breach of the Participation Agreement is granted. Because the Court has granted Defendant's motion to dismiss Plaintiff's first cause of action, the Court need not here opine as to whether or not the exculpatory clauses in the Participation Agreement and PSA also bar this cause of action.

***D. Breach of Implied Covenant of Good Faith and Fair Dealing***

In its second cause of action, Plaintiff alleges that Defendant breached the Participation Agreement by deducting 100% of its fees solely from amounts otherwise due and payable to RREEF. *See* Compl. ¶¶ 50-57.

Plaintiff's cause of action for breach of the implied covenant of good faith and fair dealing is virtually identical to its cause of action for breach of contract. Where a cause of action for breach of the implied covenant of good faith and fair dealing is duplicative of an

insufficient breach of contract claim, it is properly dismissed. *Jacobs Private Equity, LLC v. 450 Park, LLC*, 22 A.D.3d 347, 347-48 (1st Dep't 2005). Furthermore, "[c]ourts should be extremely reluctant to interpret an agreement as impliedly stating something which the parties have neglected to specifically include." *Bazin v. Walsam 240 Owner, LLC*, 72 A.D.3d 190, 195 (1st Dep't 2010).

Here, Plaintiff's cause of action for breach of the implied covenant of good faith and fair dealing must be dismissed both because it is duplicative of Plaintiff's insufficient breach of contract claim, and also because it would require this Court to create terms in the Participation Agreement that plainly do not exist. *See* discussion *supra* at Part II.B.

Accordingly, Plaintiff's second cause of action for breach of the implied covenant of good faith and fair dealing is dismissed.

*(Order of the Court follows on the next page)*

**Order**

Accordingly it is hereby

**ORDERED** that Defendant's motion to dismiss is granted and Plaintiff's Complaint is dismissed in its entirety with costs and disbursements to Defendant as taxed by the Clerk of the Court.

This constitutes the decision and order of the court.

Dated: New York, New York
July 3, 2013

ENTER:

Hon. Eileen Bransten, J.S.C.