

**Riverside Warehouse Partners, LLC v Principal  
Global Inv., LLC**

2014 NY Slip Op 30004(U)

January 2, 2014

Supreme Court, New York County

Docket Number: 653084/2012

Judge: O. Peter Sherwood

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

PRESENT: O. PETER SHERWOOD  
*Justice*

PART 49

RIVERSIDE WAREHOUSE PARTNERS LLC,

Plaintiff,

-against-

PRINCIPAL GLOBAL INVESTORS, LLC, et al.,

Defendants.

INDEX NO. 653084/2012

MOTION DATE Dec. 3, 2013

MOTION SEQ. NO. 003

MOTION CAL. NO. \_\_\_\_\_

The following papers, numbered 1 to \_\_\_\_\_ were read on this motion to amend complaint.


PAPERS NUMBERED

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 to amend the complaint is decided in accordance with the accompanying decision and order.

Dated: January 2, 2014

  
O. PETER SHERWOOD, J.S.C.

Check one:  FINAL DISPOSITION  NON-FINAL DISPOSITION

Check if appropriate:  DO NOT POST  REFERENCE

SUBMIT ORDER/ JUDG.  SETTLE ORDER/ JUDG.

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

**SUPREME COURT OF THE STATE OF NEW YORK  
COUNTY OF NEW YORK: COMMERCIAL DIVISION PART 49**

-----X  
**RIVERSIDE WAREHOUSE PARTNERS, LLC,**

**Plaintiff,**

**DECISION AND ORDER**

**-against-**

**Index No.: 653084/2012  
Mot. Seq. No. 003**

**PRINCIPAL GLOBAL INVESTORS, LLC, as Servicer; U.S. BANK, NATIONAL ASSOCIATION, as Trustee, successor in interest to Bank of America, N.A., as Trustee, successor by merger to LaSalle Bank National Association, as Trustee for Morgan Stanley Capital I Inc., Commercial Mortgage Pass-Through Certificates Series 2007-TOP25; WELLS FARGO BANK, NATIONAL ASSOCIATION as Master Servicer; C-III ASSET MANAGEMENT LLC (f/k/a ARCap Servicing, Inc.), as Special Servicer; JOSEPH SCHMITZ; and JOHN DOES(S) (NUMBERS 1-50) Unknown individuals, entities and/or corporation,**

**Defendants.**

-----X  
**O. PETER SHERWOOD, J.:**

**I. FACTUAL BACKGROUND**

This case involves a mortgage loan of \$3.5 million by plaintiff, Riverside Warehouse Partners, LLC (“Riverside”) on a commercial warehouse facility located in Riverside, California. By order dated July 12, 2013, the court dismissed the complaint without prejudice to plaintiff seeking leave to serve an amended complaint. The Court held that the documentary evidence established that Riverside defaulted on its contractual obligations to defendants by (1) terminating the lease of a tenant, Worldwide Dreams, LLC (“WWD”), without the prior written consent of defendants; (2) failing to pay over to plaintiff \$800,000 which WWD paid to Riverside in connection with early termination of the lease; and (3) failing to put up a \$252,000 letter of credit which defendants claim was triggered under a property reserves agreement (the “PRA”) executed in connection with the mortgage loan.

In the April 24, 2013 decision on which the July 12, 2013 order is based, the court observed that it felt constrained to grant the motion to dismiss even though the result seemed harsh. That

decision was predicated upon: (1) defendants' issuance of a notice of default on October 5, 2011, asserting Riverside's termination of WWD's lease without notice to defendants, and Riverside's failure to correct the default regarding termination of WWD's lease until December 13, 2011 (*i.e.*, outside the thirty (30)-day cure period set forth in the Deed of Trust) when such termination was revoked; and (2) the obligation of plaintiff to put up the letter of credit of \$252,000, which had been triggered under the PRA, and plaintiff's failure to meet that obligation.

Plaintiff now seeks leave to serve an amended complaint. In support of the motion, plaintiff asserts that additional facts and claims not detailed in the original complaint address and negate the grounds on which dismissal of the original complaint was predicated. Specifically, plaintiff contends that the amended complaint alleges material facts that the defaults asserted by defendants were not valid grounds given defendants' prior material breach of the Deed of Trust in that defendants unreasonably withheld consent to termination of the WWD lease. In addition, plaintiff seeks to claim that any alleged default by Riverside, including Riverside's alleged failure to obtain the prior consent of Lender to the conditional lease termination, was waived and estopped by defendants' conduct, specifically by continuing to collect monthly mortgage payments and reversing the previously imposed default interest payments.

Defendants oppose the motion on the ground that plaintiff has not met its burden of demonstrating that the claims asserted in proposed amended complaint have merit.

## **II. THE AMENDED COMPLAINT**

The original complaint alleged six causes of action, to wit, (1) declaratory judgment declaring that Riverside is not in default under the Loan documents and enjoining defendants from continuing to declare it to be in default, misappropriating its funds and misapplying its payments to payment of default interest and penalties (First Cause of Action); (2) breach of fiduciary duty (against US Bank, N.A., Wells Fargo, Principal Global & Schmitz) for having misappropriated and used Riverside's escrow funds to pay non-tax items such as alleged default interest (Second Cause of Action); (3) conversion of tax escrow (against US Bank, N.A., Wells Fargo, Principal Global, & Schmitz); (4) conversion of checking account funds for unauthorized invasion of the account for a use other than monthly installment payments (Fourth Cause of Action); (5) breach of covenant of good faith and fair dealing (Fifth Cause of Action); and (6) breach of contract (against US Bank,

N.A., Wells Fargo, Principal Global and C-III). In addition to declaratory and injunctive relief, Riverside seeks to recover compensatory damages, together with interest and punitive damages in an amount of at least \$2 million, plus costs, including attorneys' fees and disbursements. The gravamen of plaintiff's original complaint was that no event of default occurred under the Loan documents because Riverside did not terminate the lease with its tenant, WWD.

The proposed amended complaint asserts the same claims asserted the original complaint except that the breach of contract claim has been divided in two causes of action. In an effort to address the deficiencies of the original complaint, plaintiff substantially amplifies the fact allegations, expanding the one hundred and fourteen (114) numbered paragraphs of the original complaint to one hundred and sixty nine (169) numbered paragraphs. While not alleging a cause of action for fraud, the fact allegations both explicitly and implicitly suggest that plaintiff is claiming that defendants, by their conduct, engaged in a scheme to defraud. The additional factual allegations can be summarized as follows:

- The \$3.5 million dollar loan is over collateralized as the Property has an estimated value of more than \$12 million dollars;
- Defendants breached the loan agreement by "unreasonably" withholding consent to the plaintiff's termination of WWD's lease in an intentional effort to "coerce, burden and harass" plaintiff into prepaying the existing mortgage with "exorbitant" prepayment penalties;
- Defendants waived its right to declare defaults by accepting monthly payments of interest, continuing to have plaintiff pay real estate taxes and insurance premiums on the warehouse, and by withdrawing and reversing any previously imposed default interest charges and are estopped by the same conduct from enforcing any such alleged defaults;
- Plaintiff did not default by failing to deposit the \$252,000 Letter of Credit with defendants as WWD continued to occupy the Property and to conduct business, utilities and taxes continued to be paid, and, since the loan was over collateralized, additional collateral security for the loan was not required. Thus, defendants violated the intent of the Loan Documents by demanding the Letter of Credit;
- The payment of \$800,000 by WWD to Riverside to obtain Riverside's release of a warehouseman's lien was not a Extraordinary Rental Payment or an "indebtedness" as defined in the

Deed of Trust as it was not for any payments due under the lease such as rent, advance rent, or a lease termination fee;

- Defendants diverted and misappropriated plaintiff's tax and insurance escrow accounts;
- Defendants breached obligations under the Loan Documents by asserting that Riverside was required to obtain defendants' prior consent to subletting the Property and that such consent would not be granted unless the defaults were cured;
- Defendants breached their contractual obligations by failing to turn over to Riverside all sums in the tax and insurance escrow accounts after being informed by Riverside that it would be making all such payments directly to tax authorities and insurance company.

### III. DISCUSSION

Leave to amend a pleading pursuant to CPLR § 3025 “shall be freely given,” in the absence of prejudice or surprise (*see e.g. Thompson v Cooper*, 24 AD3d 203, 205 [1<sup>st</sup> Dept 2005]; *Zaid Theatre Corp. v Sona Realty Co.*, 18 AD3d 352, 354 [1<sup>st</sup> Dept 2005]). Mere lateness in seeking such relief is not in itself a barrier to obtaining judicial leave to amend (*see, Ciarelli v Lynch*, 46 AD3d 1039 [3d Dept 2007]). Rather, when unexcused lateness is coupled with significant prejudice to the other side, denial of the motion for leave to amend is justified (*see, Edenwald Contracting Co. v City of New York*, 60 NY2d 957, 958 [1983]). Prejudice in this context is shown where the nonmoving party is “hindered in the preparation of his case or has been prevented from taking some measure in support of his position” (*Loomis v Civetta Corinno Const. Co.*, 54 NY2d 18, 23 [1981]).

In order to conserve judicial resources, examination of the underlying merit of the proposed amendment is mandated (*Thompson, supra* at 205; *Zaid, supra* at 355). Leave will be denied where the proposed pleading fails to state a cause of action, or is palpably insufficient as a matter of law (*see Aerolineas Galapagos, S.A. v Sundowner Alexandria*, 74 AD3d 652 [1<sup>st</sup> Dept 2010]; *Thompson, supra* at 205). Thus, a motion for leave to amend a pleading must be supported by an affidavit of merit and evidentiary proof that could be considered upon a motion for summary judgment (*Zaid, supra* at 355).

As the party seeking the amendment, plaintiff has the burden in the first instance to demonstrate their proposed claims' merits, but defendants, as the parties opposing the motion, “must overcome a presumption of validity in the moving party's favor, and demonstrate that the facts alleged in the moving papers are obviously unreliable or insufficient to support the amendment”

(*Peach Parking Corp. v 346 W. 40<sup>th</sup> St. LLC*, 42 AD3d 82, 86 [1<sup>st</sup> Dept 2007]). Where there has been extended delay in seeking leave to amend, the party seeking to amend a pleading must establish a reasonable excuse for the delay (see *Heller v Louis Provenzano, Inc.*, 303 AD2d 20, 24 [1<sup>st</sup> Dept 2003]).

1. Alleged Unreasonable Withholding of Consent to Lease Termination

Riverside alleges that defendants breached obligations in the Loan Documents by unreasonably withholding consent to Riverside's termination of its lease with WWD. This argument was made in correspondence between the parties after defendants notice of default on November 29, 2011 and after Riverside was again informed of its default under the Loan Documents and demand was made for plaintiff to deliver the \$805,000 payment made by WWD to Riverside and the \$252,000 Letter of Credit pursuant to the PRA. Riverside then on December 13, 2011 executed a written amendment to its Early Termination Agreement with WWD changing the date on which the termination was to take effect. By so doing it sought to reverse the default created by the early termination. All of this was considered on the motion to dismiss the original complaint.

The proposed amended complaint, alleges facts concerning communications between Roger Gimbel, Riverside's managing member, and defendant, Joseph Schmitz, in the period August 19, 2011 and September 21, 2011, as to economic benefits that would accrue as a result of the termination of the lease with WWD. Plaintiff avers that such communications reflect its efforts to obtain defendants consent to termination of WWD's lease. These allegations fail to recognize that Article 17 of the Deed of Trust requires written consent of the Lender "prior" to termination of the Lease. It cannot be said reasonably that the Lender withheld consent to a termination regarding which it had no notice. Even assuming the communications between the parties may be deemed efforts to obtain consent, they occurred over two months after the Early Termination Agreement was signed on June 1, 2011. Thus, plaintiff had already defaulted such that the Lender was excused from any obligation to give its consent to the termination. Accordingly, plaintiff has not succeeded in making out a meritorious claim that defendants breached its obligations in the Loan Documents such that any of its alleged defaults should be excused.

In any event, where one party to a contract repudiates its obligations, the other party may treat the contract as terminated or continue it, in which case the nonrepudiating party remains obligated to perform under the contract (see *Awards.com v Kinko's, Inc.*, 42 AD3d 178, 188 [1<sup>st</sup> Dept 2007]);

*Computer Possibilities Unlimited, Inc. v Mobil Oil Corp.*, 301 AD2d 70, 80 [1<sup>st</sup> Dept 2002], *lv denied* 100 NY2d 504 [2003]). Here plaintiff chose not to terminate the contract with defendants following defendants' alleged default, and because of that election, plaintiff's defaults not cannot be excused based on defendants' alleged breach.

## 2. Waiver

"It is fundamental that '[w]aiver requires the voluntary and intentional abandonment of a known right, which, but for the waiver, would have been enforceable'" (*Computer Possibilities Unlimited, Inc.*, 301 AD2d at 80, quoting *General Motors Acceptance Corp. v Clifton-Fine Cent. School Dist.*, 85 NY2d 232, 236 [1995]). Defendants have submitted an affirmation of counsel to which is attached correspondence from counsel for Principal to plaintiff's counsel regarding application of default interest payments and acceptance of payments on the loan in December 2012 and January 2013. The correspondence expressly reserves Lender's rights and remedies. Moreover, section 22.1 of the Deed of Trust specifically provides that the Lender, by accepting payments of any sums after their due date does not waive its right to declare a default as to other payment obligations. Such clauses are enforceable (*see Awards.com* at 188). Accordingly, the claim of waiver cannot be maintained.

## 3. \$805,000 Extraordinary Rental Payment

Plaintiff's claim that the \$805,000 payment was for release of the warehouseman's lien and, therefore, does not constitute an Extraordinary Rental Payment was raised in opposition to the motion to dismiss the original complaint and essentially rejected. The payment was made pursuant to the Early Termination Agreement which states that the payment is in "consideration of . . . RIVERSIDE's agreement to terminate the Lease prior to its term." It constituted an Extraordinary Rental Payment as defined in Section 17.2 (a) of the Deed of Trust. This claim is without merit.

## 4. \$252,000.00 Letter of Credit

Plaintiff contends that it was not required to post the \$252,000 Letter of Credit and, therefore, its failure to do so is not an Event of Default. Plaintiff maintains that the purpose of the Letter of Credit was to cover re-leasing costs after the Property becomes vacant. Thus, since WWD had not vacated the Leased premises, Riverside had no obligation to post the Letter of Credit.

As plaintiff notes, Section 1 (a) of the PRA provides that the Borrower shall deposit funds and/or letters of credit to be held by the Lender “as additional security for the loan, and/ or to reimburse Borrower for the cost to complete any Tenant Improvements and pay any Leasing Commissions.” However, this provision also requires plaintiff to post a Letter of Credit “[i]f at any time during the term of the Loan . . . [WWD] . . . gives any notice of termination, intent to vacate or physically vacates its respective leased premises.” Because that event occurred here, plaintiff was required to post a Letter of Credit within fifteen (15) days thereafter. Contrary to plaintiff’s view, the triggering event is not WWD vacating the leased premises, rather it was termination of the lease or notice of its intent to terminate the lease by WWD.

Accordingly, the motion for leave to amend the complaint is DENIED.

This constitutes the decision and order of the court.

**DATED: January 2, 2014**

**ENTER,**



**O. PETER SHERWOOD**

**J.S.C.**