Spectrum Origination LLC v Hess
2014 NY Slip Op 31034(U)
April 16, 2014
Sup Ct, New York County
Docket Number: 653171/13
Judge: Melvin L. Schweitzer

SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK : PART 45

SPECTRUM ORIGINATION LLC, as Administrative Agent,	:	
Plaintiff,	:	Index No. 653171/13
-against-	:	DECISION AND ORDER
RYAN L. HESS,	:	Motion Sequence No. 001
Defendant.	:	

MELVIN L. SCHWEITZER, J.:

Spectrum Origination LLC (Spectrum) seeks to recover $29,390,337.44, plus interest, from Ryan L. Hess (Mr. Hess), pursuant to a guaranty agreement (Guaranty Agreement). Spectrum filed this motion for summary judgment in lieu of complaint pursuant to CPLR 3213. In response, Mr. Hess argues the court should deny Spectrum's motion and cross-moves for dismissal or a stay of Spectrum's action.

Background

Spectrum extended a commercial loan (Loan) to Frac Diamond Aggregates LLC (FDA) and ACG Consulting Group, LLC (ACG, and collectively with FDA, Borrowers) on May 18, 2012. Also, on May 18, 2012, Mr. Hess, who had an indirect equity interest in ACG, which, in turn, owned 54% of FDA, signed a Guaranty Agreement with Spectrum, promising to pay Spectrum the balance of the Loan in the event that Borrowers failed to repay in accordance with the terms of the controlling agreements.

The actual credit agreement between Spectrum and Borrowers (Credit Agreement) spans 75 pages, and includes 100 pages of additional schedules and exhibits. The original principal

amount of the Loan was $30,800,000. The Credit Agreement defines the various obligations of Spectrum and Borrowers, and also sets out the collateral securing the Loan.

The Guaranty Agreement states that, in the event of default, "[Mr. Hess] shall, on demand,... pay the amount due thereon to Administrative Agent[.]" The agreement states that Mr. Hess "absolutely and unconditionally guarantees" complete and full payment of the obligations of the Credit Agreement. Furthermore, the parties agreed that "[a]ny suit or proceeding arising in respect of this Guaranty or any of the matters contemplated hereby will be tried exclusively in the U.S. District Court for the Southern District of New York or, if such court does not have subject matter jurisdiction, in any state court located in the City and County of New York..."

Spectrum, the lender in this case, is a Delaware limited liability company having its principal place of business in New Providence, New Jersey.

ACG leases and operates a drying facility (Drying Facility) in Pearl River County, Mississippi, at which location raw sand and gravel are treated and then processed into frac sand and other products which are used for oil and gas exploration. FDA, ACG's parent company, owned a sand and gravel mining pit, along with related equipment and inventory (Mine).

By letter dated May 13, 2013, Spectrum notified Borrowers that their failure to pay interest when due on May 10, 2013, or within any applicable grace period, constituted an event of default under the terms of the Credit Agreement. On July 16, 2013, Spectrum further advised Borrowers that one or more events of default existed under the Credit Agreement. Spectrum sent yet one final letter, dated July 30, 2013, notifying the Borrowers of the continuing event of default under the Credit Agreement. As a result of the Borrowers failure to satisfy the conditions of the Credit Agreement, Spectrum accelerated the maturity date of the Loan, and demanded

repayment of the principal and interest then due. Borrowers subsequently failed to repay any of the outstanding principal or interest due on the loan.

On July 30, 2013, Spectrum also sent a letter directly to Mr. Hess, in which Spectrum demanded that, pursuant to the terms of the Guaranty, Mr. Hess repay the principal and interest due on the Loan. Mr. Hess failed to pay any of the principal or interest due on the Loan in breach of his absolute and unconditional obligations under the Guaranty.

On September 3, 2013, Spectrum directed the trustee under the deeds of trust securing the Mine and the Drying Facility to issue notices of foreclosure. At a non-judicial foreclosure on the Mine on October 1, 2013, Spectrum submitted a credit bid in the amount of $4,000,000, thereby acquiring the Mine. Mr. Hess alleges that Spectrum's $4,000,000 credit bid was significantly lower than the mine's actual worth, which Mr. Hess claims is somewhere between $12,500,000 and *at least* $50,330,000, based upon prior bankruptcy proceedings and valuations conducted by Blethen Mining Associates.

Mr. Hess further alleges that Spectrum frustrated the Borrowers performance of its obligations and prevented Mr. Hess from efforts to refinance the debt.

Finally, Mr. Hess alleges that a motion for summary judgment in lieu of complaint pursuant to CPLR 3213 is inappropriate because the value of the debt owed by Mr. Hess under the Guaranty Agreement is affected by supposed funds deposited into the Interest Reserve Account and the ACG Capex Account.

Discussion

Section 3213 should be resorted to sparingly, and only when the court is "convinced that no issues exist which would warrant a plenary proceeding." *Christie's, S.A. v Gugliarda*, 65 AD2d 714, 715 (1st Dept 1978). An instrument comes within CPLR 3213 only "if a *prima facie*

case would be made out by the instrument and a failure to make the payment called for by its terms. The instrument does not qualify if outside proof of nonpayment is needed, other than simple proof of nonpayment or a similar *de minimis* deviation from the face of the document." *Weissman*, 88 NY2d at 444 (quoting *Interman Indus. rods., Ltd. v R.S.M. Electron Power Inc.*, 37 NY2d 151, 155 (1975)); Weinstein, Korn & Miller, New York Practice, ¶ 3213.04.

As a preliminary matter, Mr. Hess contends that Spectrum does not have the authority to maintain this action under New York's Limited Liability Company Law 808(a). LLC Law 808(a) provides:

> A foreign limited liability company doing business in this state without having received a certificate of authority to do business in this state may not maintain any action, suit or special proceeding in any court of this state unless and until such limited liability company shall have received a certificate of authority in this state.

The burden is on the party seeking to impose the barrier to show that the foreign LLC's activities are "permanent, continuous, and regular." *See Storwal Int'l, Inc. v Thom Rock Realty Co., L.P.*, 784 F Supp 1141, 1144 (SDNY 1992); *see also Access Point Med. v Mandell*, 102082/2010, 2011 NY Misc LEXIS 3782, at *20 (Sup Ct, NY County July 29, 2011) ("the party seeking to impose the barrier, in order to rebut the presumption that the corporation does business in its state of incorporation rather than New York, has the burden of proving that the foreign corporation's activity here is systematic and regular").

To support his claim that Spectrum does business in New York within the meaning of LLC 808(a), Mr. Hess first cites the fact that Spectrum has commenced six lawsuits in New York since 2001. Six lawsuits (including the instant action), over a span of thirteen years, does not constitute "doing business" in New York and Mr. Hess has cited no authority that suggests that any number of lawsuits, standing alone, are sufficient to meet his burden. In fact,

"[i]t is well settled that [t]he mere maintenance of an action by... a foreign corporation does not constitute doing business within the State." *Fed. Fin. Co. v Levine*, 281 AD2d 454, 455 (2d Dept 2001).

Mr. Hess also submitted documents that purportedly show "regular financial dealings by Spectrum" within the state of New York, which Mr. Hess claims satisfies his burden under LLC 808(a). The documents show that on or around December 13, 2012, Spectrum and 215 W. 28th Equities LLC entered into a mortgage agreement by which Spectrum extended a loan to 215 W. 28th Equities LLC in exchange for a mortgage on a set of properties located within New York City and owned by 215 W. 28th Equities LLC. Furthermore, the documents show that on or around September 16, 2013, Spectrum assigned its security interest in these properties to Middle Patent Capital, LLC.

The mere fact that Spectrum held a security interest in property located in New York City does not constitute "permanent, continuous, and regular" business contacts under LLC 808(a). Mr. Hess' citation of *Sutton Funding, LLC v Parris* and *RMS Residential Props., LLC v. Naaze* does nothing to alter this reality. *See Sutton Funding, LLC v Parris,* 24 Misc 3d 889 (Sup Ct, Kings County 2009); *see also RMS Residential Props., LLC v Naaze*, 28 Misc 3d 843 (1st Dist Ct, Nassau County 2010). In *Sutton*, a lender sought to enforce a foreclosure action on a property located in New York. The suit was dismissed because the lender failed to satisfy the statutory requirement for maintaining a mortgage foreclosure action on property located within the state of New York. The citation of this case is misguided for two primary reasons. Firstly, the instant action is not a mortgage foreclosure action, but rather an action to enforce a personal guaranty. The statutory requirements for the commencing of a foreclosure action on property in New York are irrelevant to the outcome of this case. Secondly, the court in *Sutton* does not

discuss what it means to be "doing business" in New York under LLC 808(a), and therefore sheds no light on how to interpret Spectrum's business activities in New York.

RMS Residential Props., LLC v Naaze also fails to support the proposition that Spectrum's aforementioned mortgage constitutes "doing business in New York." The court in *RMS*, in finding that the lender in *RMS* was doing business in New York, relied upon the fact that the property being foreclosed upon was located in New York, as well as evidence that the lender had initiated twenty-five foreclosure actions in New York state over a three-year period. The instant action is distinguishable from *RMS* on both accounts. While Spectrum did in fact initiate a foreclosure proceeding on property in connection with this action, that property was located in Mississippi. More importantly, Mr. Hess has produced no evidence that Spectrum's actions in New York even approach the level of the lender in *RMS*. While twenty-five foreclosure actions may indeed constitute "permanent, continuous, and regular" business activities, one mortgage simply does not suffice.

The fact that there exists within this mortgage document a reference to Spectrum's "office in New York" does not alter this analysis. Mr. Hess is unable to provide this court with any evidence that shows what kind of activities are conducted in the office, and fails to identify an address for the supposed office space. Without determining whether owning office space in New York constitutes "doing business" under LLC 808(a), it is sufficient to say that the evidence provided by Mr. Hess with respect to the office, as with the mortgage agreement within which the office was mentioned, falls short of satisfying his burden of proof.

Inconsistent Remedy

Mr. Hess alleges that Spectrum may not proceed with their motion for summary judgment in lieu of complaint because Spectrum elected an inconsistent remedy. To allow

Spectrum to foreclose upon the Mine while also pursuing recovery via the Guaranty would be contrary to law and equity, Mr. Hess argues. There is no merit to this claim, as the terms of the Guaranty clearly state that even if Spectrum elects another remedy, "[Hess] shall nevertheless be obligated hereunder for any and all sums still owing to [Spectrum]..."

Perhaps attempting to provide some statutory basis for the argument that Spectrum was barred from pursuing other remedial measures, Mr. Hess contends that Section 3 of the Guaranty Agreement is a contractual analogue to 1301 (3) of the RPAPL, which is otherwise known as "the one-action rule." To read the Guaranty Agreement as such would be to subordinate the express and unambiguous terms of the Guaranty in favor of a statutory provision that does not apply to the transaction at issue. As such, this court will rely instead upon the explicit terms of the Guaranty Agreement, which clearly state that Mr. Hess remains obligated to Spectrum even if Spectrum moved to foreclose on the Mine prior to demanding payment from Mr. Hess.

Determining Spectrum's Rights Requires Outside Proof

Mr. Hess claims that a motion for summary judgment in lieu of complaint pursuant to 3213 is inappropriate because proof existing outside of the Guaranty Agreement is required in order to determine the liabilities and obligations under the Guaranty Agreement, and further that the Guaranty Agreement contains obligations other than the payment of money. These arguments stem from the language of CPLR 3213, which requires that an action be "based upon an instrument for the payment of money only..." N.Y. C.P.L.R. 3213 (McKinney).

With respect to Mr. Hess' first point, regarding outside proof, this Court has held before, and holds again, that a guaranty agreement by definition relates to an underlying obligation, and "the need to consult the underlying documents to establish the amount of liability does not affect the availability of CPLR 3213." *See UBS Commercial Mtge. Trust 2007-FLI v Garrison Special*

Opportunities Fund L.P., 652412/2010, 2011 NY Misc LEXIS 4634 (Sup Ct, N.Y. County March 8, 2011). Therefore, the fact that these parties must look to the Credit Agreement in order to determine exactly how much Mr. Hess owes Spectrum does not bar Spectrum from invoking CPLR 3213. Mr. Hess' tries to bolster his argument by claiming that the underlying Credit Agreement is too long or the definitions within it too complex, but this claim goes unsupported by caselaw and runs afoul of the notion that sophisticated parties are capable of engaging in complex transactions.

Mr. Hess goes on to claim that CPLR 3213 is not appropriate because the Guaranty Agreement contains obligations not involved with the payment of money, and thus the Guaranty Agreement is not "an instrument for the payment of money only." The specific provisions of the Guaranty Agreement which Hess cites are all obligations of the Borrowers, rather than the guarantor, and include obligations to stay current on tax liabilities and maintain the security interests. As this court has stated previously, "[t]he mere presence of additional provisions in the guaranty does not constitute a bar to CPLR 3213 relief, provided that the provisions do not require additional performance as a condition precedent to repayment, or otherwise alter the defendant's promise of payment." *UBS Commercial Mtge. Trust*, 2011 NY Misc LEXIS 4634, at 8. None of the obligations cited by Mr. Hess require Mr. Hess or Spectrum to take any actions prior to performance of the guarantee, and therefore they could not be construed as conditions precedent to Mr. Hess' expressly "unconditional" guarantee to pay.

Affirmative Defenses

Mr. Hess, noting that there is no explicit language within the Guaranty Agreement that waives all affirmative defenses, downplays the importance of the descriptive words "absolute" and "unconditional" in reference to Mr. Hess' promise to pay. While Mr. Hess is indeed correct

that there is no explicit waiver of affirmative defenses within the Guaranty Agreement, that fact does not mitigate the relevance of other explicit language found in the Agreement. Mr. Hess, by signing the Guaranty Agreement, made his personal liability absolute and unconditional in the event of default by the Borrowers. These types of agreements are common, and lenders in Spectrum's situation typically rely on these unconditional personal guarantees when extending the loan to the borrowers in the first place. This court therefore views any subsequent attempts by Mr. Hess to question the validity of the Guaranty Agreement with a heavy dose of skepticism.

Mr. Hess first alleges that Spectrum acquired the relevant collateral (the Mine) in a commercially unreasonable manner, which will result in a windfall for Spectrum should this court require Mr. Hess to satisfy his obligations under the Guaranty Agreement. Mr. Hess' allegation is based upon property valuations conducted by Blethen Mining Associates that were allegedly in the possession of Spectrum at the time that Spectrum acquired the Mine. The valuations indicate that the Mine could be sold on the open market for a total of $50,330,000. This figure is significantly larger than the $4,000,000 Spectrum actually paid to acquire the Mine at a credit bid auction in Mississippi. Mr. Hess thus puts forth the argument that the acquisition of the Mine at a below-market price has satisfied the debt obligations of the Borrowers under the Credit Agreement, and therefore to allow Spectrum to enforce the terms of the Guaranty Agreement against Mr. Hess would allow Spectrum to enjoy a double-recovery.

A credit bid auction is a process by which foreclosed property is sold at a public auction, with the caveat that all bidders are required to submit immediate cash payment for the property except for the lenders involved, who may discount the auction-price from the existing debt obligation. The credit bid process protects the lender against the risk that collateral will be sold at less than its fair market value. If Mr. Hess is asking this court to determine the market value

of the Mine, it seems quite clear that the dollar amount that the Mine actually sold for when put up for sale would be a more reliable indicator of value than a third-party consulting firm's hypothetical valuation. Mr. Hess does not allege that Spectrum failed to advertise the public auction, or manipulated the public auction, or in any way unilaterally dictated the terms of the sale. Indeed, if Mr. Hess does have an issue with how the process was handled in Mississippi in this particular case, he should assert those claims in a court of Mississippi. For the purposes of this court, the credit bid auction in question gave anyone interested in purchasing the Mine an opportunity to do so. The speculative valuations of the Mine by a third party are thus irrelevant to the resolution of this dispute.

All of this is not to say that the $4,000,000 that Spectrum actually paid for the Mine *is* irrelevant to the resolution of this dispute. This amount, which Spectrum discounted from the debt obligations of the Borrowers, reduces Spectrum's claim against Mr. Hess in this case from the $33,390,337.44 originally requested to $29,390,337.44. Spectrum acknowledges this reduction, and indeed only requested $33,390,337.44 in the first place because the foreclosure proceedings occurred after their original motion was filed. In reference to a previous argument put forth by Mr. Hess, the change in the amount sought to be recovered does not bar Spectrum from invoking CPLR 3213. The subtractions of amounts already recovered from the total debt obligation do not amount to "requiring outside proof" under the relevant portions of the statute.

Mr. Hess asserts that there are various bank accounts controlled by Spectrum that place in question the amount of the guaranteed obligations. In particular, he cites monies delivered at the closing of the loan into an Interest Reserve Account, ACG Capex Account and monies in Free Cash Flow Sweeps. Mr. Hess does not assert that any of these monies have been used to pay down the Loan. Yet he wants to defeat his obligations under the Guaranty by arguing that to

permit double payment of the Loan would be grave overreaching. It surely would, but he has provided no facts to suggest that any such monies were used to pay down the Loan. He has made only conclusory allegations that do not bar judgment here.

Finally, Mr. Hess urges the Court to find that Spectrum violated the implied covenant of good faith and fair dealing in the Guaranty Agreement by frustrating the Borrowers ability to pay their debt to Spectrum. The crux of Mr. Hess' claim is detailed in Mr. Hess' affidavit, and is centered primarily around the actions of a former manager and member of ACG, Mr. Moreno. The nature of the allegation does not require a detailed recitation of the facts. It is sufficient to say that Mr. Hess believes a combination of Mr. Moreno, President of FDA Jeffrey Bartlam, and Spectrum acted in concert to eliminate Mr. Hess' interest in the Mine and the Drying Facility. These allegations, which are both vague and unsupported, are also irrelevant to the resolution of this dispute. As the court in *Stevens v Phlo Corp.* stated, "[d]efendant's claim that plaintiff tortiously interfered with its relations with a prospective investor is based on facts unrelated to the note, and therefore does not defeat the CPLR 3213 motion." *Stevens v Phlo Corp.*, 288 AD2d 56, 56 (1st Dept 2001). If Mr. Hess or Borrowers have claims against Spectrum with respect to their behavior leading up to and subsequent to the event of default, then these claims should be brought in a separate action, not intertwined with Mr. Hess' unconditional and absolute obligations under the Guaranty Agreement.

Accordingly, it is

ORDERED that plaintiff's motion for summary judgment is granted. Submit judgment.

Dated: April 16, 2014

ENTER:

J.S.C.

MELVIN L. SCHWEITZER