1604-1610 Broadway Owner, LLC v U.S. Bank, N.A.
2016 NY Slip Op 31196(U)
February 11, 2016
Supreme Court, New York County
Docket Number: 650772/2013
Judge: Saliann Scarpulla
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SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK: PART 39

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1604-1610 BROADWAY OWNER, LLC and SL GREEN MANAGEMENT CORP.,

Plaintiffs,

-against-

U.S. BANK, N.A., AS TRUSTEE FOR THE REGISTERED HOLDERS OF GE COMMERCIAL MORTGAGE CORPORATION, COMMERCIAL MORTGAGE PASS-THROUGH CERTIFICATES, SERIES 2007-C1,

Defendant.

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DECISION/ORDER

Index No. 650772/2013
Motion Seq. No. 003

HON. SALIANN SCARPULLA, J.:

In this action arising from an alleged breach of a commercial loan agreement, plaintiffs 1604-1610 Broadway Owner, LLC ("Broadway") and SL Green Management Corp. ("SL Green") (collectively, "Plaintiffs") move to dismiss defendant U.S. Bank, N.A.'s ("U.S. Bank") amended counterclaims and sixth affirmative defense.[1]

Broadway owned a master leasehold interest that consisted of several floors in two buildings located at 1604-1610 Broadway and 732-736 Seventh Avenue, New York, NY ("the property"). Broadway alleges that its lease with the landlord, Farmore Realty Inc.,

[1] U.S. Bank, N.A. is named as the defendant in its capacity as trustee for the registered holders of GE Commercial Mortgage Corporation, Commercial Mortgage Pass-Through Certificates, Series 2007-C1.

was originally scheduled to expire in July 2021. SL Green served as manager and leasing agent for the property.

In 2007, Broadway borrowed $27 million ("the loan") from Deutsche Bank Mortgage Capital, LLC. In exchange for the loan, Broadway signed a promissory note ("the Note") and a leasehold mortgage and security agreement ("Mortgage Agreement"). Under the Mortgage Agreement, Broadway granted a leasehold mortgage to Deutsche Bank, which pledged its leasehold interest in the property as collateral for the loan. Subsequently, Deutsche Bank securitized the loan and sold the resulting commercial mortgage-backed securities to U.S. Bank.

On March 5, 2013, Plaintiffs commenced this action against U.S. Bank for breach of contract and tortious interference with prospective economic advantage. In the first cause of action, Plaintiffs assert that: (1) U.S. Bank breached the Mortgage Agreement by failing to approve a proposed sublease to Adventure Entertainment, LLC, a company that intended to operate a Jekyll & Hyde theme restaurant on the property; and (2) U.S. Bank breached a March 31, 2010 letter agreement between the parties ("the Letter Agreement") which provided that SL Green would receive $800,000 in management and leasing fees from the proposed sublease to Adventure Entertainment, LLC. On January 8, 2014, Justice Barbara Kapnick dismissed the second cause of action for tortious interference.

In the complaint, Plaintiffs allege that under the Mortgage Agreement, the proposed sublease required U.S. Bank's prior written approval which could "not be unreasonably withheld, conditioned or delayed." Plaintiffs claim that, due to U.S. Bank's failure to respond to and approve the proposed sublease, Broadway was unable to make

rent payments to the landlord or loan payments to U.S. Bank. After Broadway's failure to pay rent in late 2009, U.S. Bank began making protective advances by paying rent to the landlord on Broadway's behalf. These protective advances by U.S. Bank continued until December 2012, after which the landlord commenced a non-payment and eviction proceeding against Broadway in Civil Court, New York County, Index No. 90151/2012. The Civil Court proceeding ultimately resulted in Broadway's eviction from the property. In this action, Plaintiffs now seek to recover $20 million in damages from U.S. Bank for lost rental income, management fees, leasing fees, and the diminished value and dispossession of the leasehold interest.

In response to the complaint, U.S. Bank asserted nine affirmative defenses and three amended counterclaims for: 1) a declaratory judgment; 2) breach of contract; and 3) attorney's fees.[2] In the first counterclaim, U.S. Bank seeks a declaration that: (1) Broadway defaulted on the loan by failing to make rent and loan payments, failing to pay the balance of the loan on the maturity date, and by committing material waste; and that (2) U.S. Bank may seek a $46.2 million offset against Plaintiffs' damages award to cover the unpaid loan amount, protective advances, and waste. The sixth affirmative defense also seeks an offset for the amount that Broadway owes to U.S. Bank. As to the second counterclaim, U.S. Bank alleges that Plaintiffs breached the Mortgage Agreement by

[2] U.S. Bank served an answer on February 6, 2014, and an amended answer with counterclaims on February 26, 2014. U.S. Bank then interposed stand-alone amended counterclaims on May 30, 2014. Plaintiffs consented to the amendment of U.S. Bank's counterclaims by withdrawing their prior motion to dismiss the original counterclaims.

intentionally permitting waste to occur on the property. In the third counterclaim, U.S. Bank seeks attorneys' fees in connection with this suit and for enforcing the terms of the Note and Mortgage.

In their current motion, Plaintiffs argue that U.S. Bank's counterclaim for an offset should be dismissed because the loan is non-recourse, and U.S. Bank may only recover the collateral for the loan, i.e., the leasehold interest. In the alternative, Plaintiffs argue that U.S. Bank waived any waste claim against Broadway in the Letter Agreement.

In opposition to the motion, U.S. Bank contends that the non-recourse provision in the Note does not affect its right to seek an offset from Plaintiff's damages award, but only precludes it from seeking a money judgment. In addition, U.S. Bank asserts that it may seek an offset under the general damages principle that allows a contracting party to offset out-of-pocket costs incurred after the other contracting party's breach of contract. U.S. Bank further argues that, even if the non-recourse provision bars recovery of the unpaid loan amount, U.S. Bank may still recover for protective advances and waste.

Discussion

I. First Counterclaim for Declaratory Judgment

In the first counterclaim, U.S. Bank seeks an offset for three categories of expenses: (a) the unpaid loan amount; (b) expenses for curing and preventing waste on the property; and (c) $6.2 million in protective advances. Plaintiffs move to dismiss this claim on the grounds that U.S. Bank is precluded from seeking an offset because the loan contains a non-recourse provision.

Section 6(a) of the Note provides that, except under certain circumstances, Broadway "shall be liable upon the indebtedness evidenced hereby and for the other obligations arising under the Loan Documents to the full extent (but only to the extent) of the security." The Note further states that "no attachment, execution or other writ of process, including any action or proceeding wherein a money judgment shall be sought against Maker [Broadway], shall be sought, issued or levied upon any assets . . . of Maker other than the Security Property."

Here, the terms of the Note plainly provide that the loan is non-recourse and that U.S. Bank is limited to recovering the collateral in the event of default, unless an exception applies. U.S. Bank contends that, although the non-recourse clause bars it from pursuing a money judgment against Broadway, it may still seek an offset for Broadway's outstanding debt to U.S. Bank.

The Note specifically addresses whether U.S. Bank's may recover the three categories of expenses sought in this lawsuit from sources other than the collateral itself. Unless resort to sources outside the collateral is permitted under the Note and Mortgage, U.S. Bank may not contravene the terms of the Note or Mortgage Agreement by simply recasting an expense as an "offset."

Unsurprisingly, the first category of expenses – the unpaid loan amount – is expressly precluded by the non-recourse provisions in the Note. The Note specifically stated that Broadway would be liable for the indebtedness of the Note only to the extent of the security, and therefore U.S. Bank's counterclaim seeking an offset for the unpaid loan amount is dismissed. Concerning the second category of expenses – intentional

waste – Broadway is entitled to recover any expenses that fall within the exception provided for intentional waste under Section 6(b) of the Note. Section 6(b) states that notwithstanding the non-recourse provision, Broadway remains "fully and personally liable . . . (vi) for intentional material waste committed on the Security Property by, or damage to the Security Property as a result of the intentional misconduct or gross negligence of, Maker."

As to the third category, Plaintiffs argue that protective advances were added to Broadway's indebtedness under the Note, which had the effect of making the protective advances subject to the non-recourse provision. Plaintiffs correctly point out that, under Section 11.5 of the Mortgage Agreement, U.S. Bank's disbursement of "any sums . . . necessary or desirable to protect or enforce the security of this Mortgage" were to be treated as "additional indebtedness of Mortgagor [Broadway] secured by this Mortgage and by all of the other Loan Documents securing all or any part of the Debt." Because U.S. Bank agreed that any sums that it disbursed to protect the security – such as protective advances – would be added to the indebtedness under the Note, U.S. Bank is barred from recovering those amounts because they are subject to the non-recourse provision.

For the reasons stated above, Plaintiffs' motion to dismiss the first counterclaim for a declaratory judgment and sixth affirmative defense is granted as to the unpaid loan amount and protective advances, and denied with respect to intentional waste.

II. Second Counterclaim for Breach of Contract

Next, Plaintiffs move to dismiss U.S. Bank's counterclaim alleging that Broadway breached the Note and the Mortgage Agreement by intentionally permitting waste on the property. Plaintiffs contend that U.S. Bank does not adequately plead that Broadway committed intentional waste on the property, or alternatively that U.S. Bank released any waste claim against Broadway in the Letter Agreement.

As discussed above, U.S. Bank may seek damages for intentional waste pursuant to the non-recourse exception in Section 6(b) of the Note. In the second counterclaim, U.S. Bank alleges that Broadway is liable for intentional waste because it abandoned the property and permitted material waste to occur, which required U.S. Bank to fund "the operations, maintenance and repair of the Property since 2010, including funding critical heating/cooling and plumbing maintenance, to avoid physical deterioration at the property." I find that U.S. Bank has sufficiently pled that Broadway committed intentional waste by leaving the property in a state of disrepair that required Broadway to pay for heating, cooling, and plumbing repairs. While Plaintiffs argue that U.S. Bank's measures to avoid deterioration of the property indicates that no waste existed, the act of "[p]ermitting property to remain in disrepair" may constitute waste. *Staropoli v. Staropoli*, 180 A.D.2d 727, 727 (2d Dep't 1992); *Rumiche Corp. v. Eisenreich*, 40 N.Y.2d 174, 179 (1976); *Travelers Ins. Co. v. 633 Third Assoc.*, 14 F.3d 114, 121 (2d Cir. 1994).

In addition, Plaintiffs move to dismiss the breach of contract counterclaim on the grounds that the Letter Agreement specifically released Broadway from liability for any

waste on the property. In March 2010, the parties entered into the Letter Agreement, which provided that Newmark & Co. Real Estate Inc. ("Newmark") would replace SL Green as property manager pursuant to a separate contract, the "Newmark Management Agreement." In light of this change of management, the Letter Agreement provided that Broadway shall be released from "any responsibility or obligation for the management, maintenance, repair or operation of the Property to the extent that such obligations were undertaken by Newmark under the Newmark Management Agreement."

Based on the terms of the Letter Agreement, Plaintiffs demonstrate that Broadway is not liable for any intentional waste created on the property after March 31, 2010, to the extent that such waste resulted from Newmark's management of the property pursuant to the Newmark Management Agreement. The Letter Agreement, however, does not release Broadway from liability for intentional waste that it committed on the property prior to March 31, 2010, or from any intentional waste that Broadway committed on the property after March 31, 2010 and not within the scope of Newmark's management obligations under the Newmark Management Agreement.

Accordingly, Plaintiffs' motion to dismiss the second counterclaim for breach of contract is granted with respect to any intentional waste created after March 31, 2010, to the extent that such waste resulted from Newmark's management of the property pursuant to the Newmark Management Agreement.

III. Third Counterclaim for Attorney's Fees

U.S. Bank seeks attorney's fees incurred in this action and for all other efforts to enforce the Mortgage Agreement. Plaintiffs argue that this claim should be dismissed because U.S. Bank may only seek attorney's fees in a mortgage foreclosure proceeding, and not in a breach of contract action.

Section 15.7 of the Mortgage Agreement states that "Mortgagor [Broadway] shall pay on demand all of Mortgagee's expenses incurred in any efforts to enforce any terms of this Mortgage, whether or not any lawsuit is filed and whether or not foreclosure is commenced, but not completed, including . . . reasonable legal fees and disbursements." Under this provision, U.S. may clearly seek attorney's fees in any action "to enforce any terms of this Mortgage" regardless of whether a foreclosure proceeding is commenced. U.S. Bank may therefore seek attorney's fees to the extent that its counterclaims seek to enforce the terms of the Mortgage Agreement. Plaintiffs' motion to dismiss the third counterclaim for attorney's fees is denied.

In accordance with the foregoing, it is hereby

ORDERED that plaintiffs 1604-1610 Broadway Owner, LLC and SL Green Management Corp.'s motion to dismiss defendant U.S. Bank, N.A.'s amended counterclaims pursuant to CPLR §§ 3211(a)(1) and (a)(7) is granted as to: (1) the first counterclaim for a declaratory judgment with respect to an offset for the unpaid loan amount and protective advances, and (2) the second counterclaim for breach of contract with respect any intentional waste created after March 31, 2010, to the extent that such

waste resulted from Newmark's management of the property pursuant to the Newmark Management Agreement, and otherwise denied; and it is further

ADJUDGED and DECLARED that U.S. Bank is barred from seeking an offset for the unpaid loan amount and protective advances; and it is further

ORDERED that U.S. Bank's remaining portion of the first counterclaim for a declaratory judgment is severed and continued; and it is further

ORDERED that plaintiffs 1604-1610 Broadway Owner, LLC and SL Green Management Corp.'s motion to dismiss defendant U.S. Bank, N.A.'s sixth affirmative defense for an offset pursuant to CPLR § 3211(b) is granted with respect to the unpaid loan amount and protective advances, and denied with respect to intentional waste; and it is further

ORDERED that counsel are directed to appear for a compliance conference at 60 Centre Street, Room 208, on February 24, 2016 at 2:15pm.

This constitutes the decision and order of the Court.

DATE : 2/11/16

Saliann Scarpulla
SALIANN SCARPULLA, JSC