

111 W. 57th Inv. LLC v 111 W57 Mezz Inv. LLC
2020 NY Slip Op 34520(U)
January 27, 2020
Supreme Court, New York County
Docket Number: 655031/2017
Judge: O. Peter Sherwood
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SUPREME COURT OF THE STATE OF NEW YORK
NEW YORK COUNTY

PRESENT: HON. O. PETER SHERWOOD PART IAS MOTION 49EFM

Justice

111 WEST 57TH INVESTMENT LLC, et al.,
Plaintiffs,

INDEX NO. 655031/2017
MOTION DATE 07/24/2019
MOTION SEQ. NO. 004

- v -

111 W57 MEZZ INVESTOR LLC,
Defendant.

DECISION + ORDER ON MOTION

The following e-filed documents, listed by NYSCEF document number (Motion 004) 113, 114, 115, 116, 117, 118, 119, 120, 121, 122, 123, 124, 125, 126, 127, 128, 129, 130, 131, 132, 133, 134, 135, 136, 137, 138, 142, 143, 144

were read on this motion to/for DISMISSAL

Upon the foregoing papers, it is ordered that this motion to dismiss (Motion Sequence Number 004) is decided in accordance with the accompanying decision and order.

1/27/2020
DATE

O. P. Sherwood
O. PETER SHERWOOD, J.S.C.

Form with checkboxes for: CHECK ONE: CASE DISPOSED, GRANTED, DENIED, NON-FINAL DISPOSITION, GRANTED IN PART, OTHER, APPLICATION: SETTLE ORDER, SUBMIT ORDER, CHECK IF APPROPRIATE: INCLUDES TRANSFER/REASSIGN, FIDUCIARY APPOINTMENT, REFERENCE.

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

-----X
**111 WEST 57TH INVESTMENT LLC, on behalf of
itself and derivatively on behalf of 111 WEST 57TH
PARTNERS LLC and 111 WEST 57TH MEZZ 1 LLC,**

**DECISION AND ORDER
Index No.: 655031/2017**

Mot. Seq. No.: 004

Plaintiffs,

-against-

111 W57 MEZZ INVESTOR LLC,

Defendant,

**111 WEST 57TH PARTNERS LLC and 111 WEST 57TH
MEZZ 1 LLC,**

Nominal Defendants.

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

Defendant 111 W57 Mezz Investor LLC (Lender) moves, pursuant to CPLR 3211 (a) (1) , (5), and (7), to dismiss the amended verified complaint (Complaint). The Complaint alleges six causes of action. The first seeks a declaration that Lender: (1) violated its obligation of good faith; (2) failed to obtain plaintiff’s consent to its proposal to accept certain collateral in full satisfaction of an obligation under a “Junior Mezzanine Loan;” (3) received an effective notification of objection, pursuant to UCC § 9-620 (a) (2); and (4) was, therefore, not entitled to accept the collateral that it received in satisfaction of the obligation secured by it. The second alleges an improper “strict foreclosure,” in violation of UCC Article 9. The third alleges conversion. The fourth alleges aiding and abetting a breach of fiduciary duty. The fifth alleges breach of contract. The sixth seeks a permanent injunction, as well as the imposition of a constructive trust.

This action arises out of the financing of a luxury residential construction project (Project) on West 57th Street in Manhattan. Initially, the Project was financed by a \$400 million mortgage loan to nonparty 111 West 57th Street Property Owner LLC (Fee Owner) and a \$325 million mezzanine loan to nonparty 111 West 57th Holdings LLC (Senior Mezz Borrower), secured by its 100% membership in Fee Owner. On March 28, 2017, the mezzanine loan was split into a senior

component in the principal amount of \$300 million, and a junior component in the principal amount of \$25 million (the Junior Mezz Loan), to be repaid by nominal defendant 111 West 57th Mezz I LLC (Borrower), and secured by its 100% interest in Senior Mezz Borrower. The terms of the Junior Mezz Loan are set forth in a Junior Mezzanine Construction Loan Agreement dated March 28, 2017 (Loan Agreement). A “Pledge Agreement” of the same date created Lender’s security interest and provided, in relevant part, that, in the event of a default under the Junior Mezz Loan, Lender “may exercise ... all rights and remedies of a secured party under the [Uniform Commercial] Code in effect in each applicable jurisdiction.” Sinatra affirmation in support, exhibit C, ¶ 8 (a). It is the exercise of those rights that is the subject of this action.

Nonparties Kevin Maloney (Maloney) and Michael Stern (Stern) provided various guarantees for financing of the Project, including a non-recourse carve-out guaranty (Guaranty). Pursuant to the Loan Agreement and the Guaranty, Borrower and the guarantors would become personally liable for the Junior Mezz Loan if, among other things, Borrower or any guarantor attempted “in bad faith . . . to materially delay any foreclosure against the Collateral or any other exercise by Lender of its remedies under the Loan Documents.” *Id.*, exhibit B, ¶ 8.31.2 and exhibit D, ¶ 3.

By notice dated January 3, 2017, nonparty Apollo Credit Opportunity Fund III AIG I LP (Apollo), the senior mezzanine lender, notified Senior Mezz Borrower that the loan was “out of balance,” that is, that the anticipated cost of completing the Project exceeded all available funds for doing so, and that a payment of approximately \$57 million was needed to cure the imbalance. For the next several months, Apollo and Senior Mezz Borrower negotiated a series of settlements that deferred further action by the former. On June 28, 2017, Apollo assigned *the Junior Mezz Loan*, and all evidencing and securing of it, to Lender, pursuant to a “First Amendment To Amended And Restated Intercreditor Agreement” *See* Complaint, exhibit B. Almost immediately, Lender delivered a notice of an event of default to Borrower, based on the latter’s failure to make the \$57 million payment, and after Borrower again failed to make that payment, Lender, on or about July 7, 2017, acting pursuant to UCC § 9-620, sent Borrower, by its managing member, nonparty 111 West 57th Sponsor LLC (Sponsor), a written proposal to retain Borrower’s collateral, that is Borrower’s 100% interest in Senior Mezz Borrower, in satisfaction of the Junior Mezz Loan. Sponsor informed plaintiff of the strict foreclosure proposal. Plaintiff urged Sponsor to object thereto on Borrower’s

behalf. Sponsor refused. As a result, Borrower's interest in Senior Mezz Borrower was foreclosed upon by operation of law, and plaintiff's investment was wiped out. Plaintiff had moved for a preliminary injunction barring the strict foreclosure. That motion was denied by then-Justice Bransten. On appeal, the Appellate Division, First Department affirmed on the ground that the foreclosure had already happened, but it pointed out that plaintiff was free to seek leave to file an amended complaint, and, in such complaint, to seek damages and a constructive trust. *AmBase Corp. v Spruce Capital Partners LLC*, 168 AD3d 514, 515 (1st Dept 2019).

The foregoing summary of the relevant facts is undisputed. The court now turns to the substantive causes of action alleged in the Complaint.

In an ordinary, common law foreclosure that is brought for failure to pay a debt, the collateral that is foreclosed upon is sold at a public auction, and, in general, the market determines the purchase price of the collateral. In a strict foreclosure, pursuant to Article 9 of the UCC, however, there is no bidding, and, assuming that all the safeguards in Article 9 are observed, the collateral is transferred to the creditor by operation of law. Accordingly, UCC § 1-203 "imposes an obligation of good faith on a secured party's enforcement under this Article." UCC § 9-620, Official Comment 11. *See also TAP Holdings, LLC v Orix Finance Corp.* 45 Misc 3d 1217 (A), Sup Ct, NY County 2014). In *Stillwater Liquidating LLC v Partner Reins. Co., Ltd.* (151 AD3d 585 [1st Dept 2017]), the Court affirmed the lower court's denial of a motion to dismiss a claim challenging a strict foreclosure on the ground of bad faith, where plaintiff alleged that the lender would obtain "rights . . . with a value far in excess of the amount owed." *Stillwater*, 2017 NY SlipOp 30257 (U) (Sup Ct, NY County, 2017). Here, plaintiff alleges that the collateral foreclosed upon greatly exceeded the underlying debt. In addition, while plaintiff, as a member of the LLC that owned the collateral, lacked standing to object to the strict foreclosure, the Complaint alleges that Lender suborned Stern and Maloney, who were officers of Sponsor, by promising them economic benefits if they caused Sponsor to refrain from objecting to the strict foreclosure on plaintiff's behalf. Accordingly, the second cause of action survives.

The third cause of action is redundant to the second, inasmuch as, if the UCC claim succeeds, then the claim of conversion will offer plaintiff no additional relief. If, on the other hand, the strict foreclosure is found to have been properly effected, then there can be no claim of conversion,

because the property in question will have passed by a proper operation of law. Accordingly, the third cause of action is dismissed.

The fourth cause of action alleges that defendant aided Sponsor, Stern, and Maloney to breach their fiduciary duty to plaintiff. Relying upon *Celestial RXInvestments, LLC v Krivulka* (2017 WL 416990 [Del Ch, Jan 31, 2017, C.A. No. 1173-VCG] (*Celestial I*) and 2019 WL 1396764 [Del Ch March 27, 2019, C.A. No. 11733-VCG]), plaintiff contends that the fourth cause of action fails, because the plaintiff and Sponsor waived all common law fiduciary duties to each other. For the following reason, however, the reasoning of the *Celestial* court is inapplicable, here. The contractual passage at issue in *Celestial* provides, in relevant part:

“[N]otwithstanding anything to the contrary in this Agreement, neither the Manager nor any of the members of the Bord of Directors . . . shall have any fiduciary duties to the Company or the Members . . . for a breach of any duty that does not involve (i) an act or omission not in good faith or which involves intentional misconduct or a knowing violation of law; or. . . .”

Celestial I, at *16. Accordingly, the *Celestial* court held that the fiduciary duties carved out of the denial of such duties, were themselves contractual in nature and, therefore, did not support a claim sounding in tort. Here, by contrast, the governing agreement provides:

“Except as otherwise expressly provided in this Agreement, none of the Members shall have any duties or liabilities to the Company or any other Member (including fiduciary duties), . . . provided, however, that this Section 8.5 shall not eliminate or limit the liability of such parties (i) for acts or omissions that involve fraud, intentional misconduct or a knowing and culpable violation of law, or”

Amended and Restated Limited Party Agreement. Sinatra affirmation, exhibit A to Verified Complaint, ¶ 8.5 (underlining in original). Thus, here, unlike the agreement in *Celestial*, applicability of the operative contract is limited so as to retain certain duties, *e.g.*, not to commit fraud or intentional misconduct, that exist on a basis that is not, itself, contractual. Accordingly, the aiding and abetting claim shall be retained.

While Lender argues that Sponsor had a legitimate reason not to object to the strict foreclosure, that argument merely raises an issue of fact. The Complaint alleges that Lender improperly influenced Sponsor to refrain from objecting to the strict foreclosure, by promising substantial financial benefits to Stern and Maloney if they caused Sponsor to so refrain. Accordingly, the fourth cause of action survives.

The fifth cause of action alleges breach of the implied covenant of good faith and fair dealing, inasmuch as defendant acted in bad faith in exercising its rights under the UCC. *See* Plaintiff's Memorandum of Law in Opposition, at 20. This claim, too, is redundant to the second cause of action and shall be dismissed.

Inasmuch as the causes of action that remain will suffice, if plaintiff prevails on them, to warrant, at least in part, the declaratory and substantive relief sought in the first and the sixth causes of action, those claims are also not dismissed.

Accordingly, it is hereby

ORDERED that the motion of defendant 111 W 57 Mezz Investor LLC (Motion Sequence Number 004) is granted to the extent that the third (conversion) and fifth (breach of the covenant of good faith and fair dealing) causes of action are dismissed, and the motion is otherwise denied; and it is further

ORDERED that counsel for the parties shall appear at a status conference on Tuesday, March 3, 2020 at 9:30 AM in Part 49, Courtroom 252, 60 Centre Street, New York New York.

This constitutes the decision and order of the court.

DATED: January 27, 2020

ENTER,


O. PETER SHERWOOD J.S.C.