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

PRESENT: _____ Justice PART 45

UBS

INDEX NO. 652412/10

MOTION DATE _____

- v -

Garrison Special Opportunities

MOTION SEQ. NO. 001

MOTION CAL. NO. _____

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

	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 by plaintiff for summary judgment is GRANTED per the attached Decision and Order.

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

Dated: March 8, 2011

Marcy L. Adams J.S.C.

Check one: ✓ FINAL DISPOSITION NON-FINAL DISPOSITION

Check if appropriate: DO NOT POST

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

UBS Commercial Mortgage Trust 2007-FL1, Commercial Mortgage Pass-through Certificates, Series 2007-FL1, and Normandy Reston Office, LLC,	:	
Plaintiffs,	:	Index No. 652412/2010
-against-	:	DECISION AND ORDER
Garrison Special Opportunities Fund L.P.,	:	Sequence No. 001
Defendant.	:	

MELVIN L. SCHWEITZER, J.:

This matter involves, *inter alia*, the validity of a guaranty of a real estate financing loan by a sophisticated distressed real estate investment fund. The core question in the case is whether the action is based upon an instrument for the payment of money only and, therefore, entitles plaintiff to bring an action for summary judgment pursuant to CPLR 3213.

Background

In July 2007, UBS Real Estate Securities Inc. (as Original Lender) entered into a First Mortgage Loan Agreement (the Loan Agreement) with Penzance Cascades North, LLC, Penzance Cascades West, LLC, Penzance Parkridge Five, LLC, and Penzance Parkridge Two, LLC (collectively, Borrowers). Pursuant to the Loan Agreement, the Original Lender loaned the Borrowers the aggregate principal amount of $107,000,000 (the Loan)[1] for the purpose of acquiring certain properties located in Reston, Virginia (the Properties). Borrowers executed a Promissory Note (the Note) evidencing the Loan. Plaintiffs subsequently became the successors-

[1] The principal amount of the Loan is presently $111,514,324.

in-interest to the Original Lender when the Original Lender assigned its interest in the Loan Agreement to plaintiffs.

Additional financing was obtained by the equity owner of the Borrowers in the form of a mezzanine loan in the principal amount of $31,500,000, secured by a pledge of 100% of the membership interests in the Borrowers. In December 2007, the mezzanine loan was assigned to defendant, Garrison Special Opportunities Fund LP (Garrison). At the time Garrison became the holder of the mezzanine loan, it was not a guarantor of the obligations of the Borrowers under the Loan Agreement.

The Borrowers did not make payment to plaintiffs on August 9, 2009, the date the Loan initially became payable in full. Borrowers exercised the Loan Agreement's option for a one-year extension and extended the maturity date to August 9, 2010. Borrowers did not make payment to plaintiffs when the Loan became due on August 9, 2010. On August 26, 2010, plaintiffs notified Borrowers that the outstanding balance of the Loan had become due and payable.

Garrison requested that plaintiffs forbear from exercising certain rights and remedies under the Loan for a period of time ending on November 1, 2010 (the Forbearance Period). On September 28, 2010, Garrison and plaintiffs entered into a letter agreement pursuant to which plaintiffs agreed that, during the Forbearance Period, they would forbear from completing a foreclosure of the mortgage and divesting Borrowers of title to the Properties. As a condition to plaintiffs agreeing to the forbearance, on September 28, 2010, defendant executed and delivered to plaintiffs a Guaranty of Recourse Obligations (the Guaranty).

Under the terms of the Guaranty, defendant unconditionally guaranteed to plaintiffs the payment and performance of obligations or liabilities of borrower to lender under Section 11.22 of the Loan Agreement (except clause (iii) of such Section 11.22) (Guaranteed Obligations) to the extent such obligations and liabilities arose after the acquisition of all or any part of the ownership interest in Borrowers by Garrison. Section 11.22 of the Loan Agreement provides that the amount of the Loan shall be fully recourse to Borrowers in the event that Borrowers file a voluntary petition under the Bankruptcy Code or any other Federal or state bankruptcy or insolvency law.

In the event that the Loan becomes fully recourse, the Guaranty makes clear that Garrison is to pay the Guaranteed Obligations immediately upon the plaintiff's demand. It states:

> If all or any part of the Guaranteed Obligations shall not be punctually paid when due, whether by demand, maturity, acceleration or otherwise, Guarantor shall, immediately upon demand by Lender, and without presentment, protest, notice of protest, notice of non-payment, notice of intention to accelerate the maturity, notice of acceleration of the maturity, or any other notice whatsoever, pay in lawful money of the United States of America, the amount due on the Guaranteed Obligations to Lender at Lender's address as set forth [in the Guaranty].

On November 1, 2010, Garrison consummated a UCC foreclosure sale on the Properties and acquired 100% of the ownership interests in the Borrowers. On December 15, 2010, each Borrower filed a voluntary petition under the Bankruptcy Code in the United States Bankruptcy Court for the Southern District of New York. On December 20, 2010, plaintiffs demanded payment from defendant under the Guaranty. Defendant has not made any payment under the Guaranty.

Plaintiffs have initiated this motion pursuant to CPLR 3213 for summary judgment in lieu of complaint. CPLR 3213 provides in relevant part that "when an action is based upon an

instrument for the payment of money only . . . the plaintiffs may serve with the summons a notice of motion for summary judgment and the supporting papers in lieu of a complaint."

Discussion

Defendant opposes the motion arguing that the Guaranty is not an instrument for the payment of money only, that the Guaranty is an unenforceable penalty, and that the Guaranty is against public policy in that it induces Garrison to breach its fiduciary duties and impedes commercially desirable real estate finance restructuring. The court addresses these issues seriatim.

Instrument for the Payment of Money Only

Defendant, relying on *Dresdner Bank AG v Morse/Diesel, Inc.*, 115 AD2d 64 (1st Dept 1986) and *U.S. Bank Nat'l Ass'n v Jeremias*, 2010 NY Misc. Lexis 2764 (NY Sup Ct 2010), contends that the Guaranty does not qualify as an instrument for the payment of money only, as it includes performance as well as payment obligations and requires more than a de minimus deviation from the face of the document to determine how much money is owed. In the first respect, it points out that the Guaranty includes promises to cooperate with respect to the implementing of secondary market transactions, to cooperate with, and provide information to, rating agencies, to subordinate any lien the guarantor possesses on the Borrowers' assets to plaintiffs liens and to refrain from certain actions, such as exercising creditor's rights with respect to Borrowers' assets. With respect to the second point, plaintiff points out that reference must be made to the 116 page Loan Agreement to determine the guaranteed obligations and the amount of defendants liability under the Guaranty.

The court is not persuaded by defendant's arguments and turns to the learning of *Bank of America, N.A. v Solow*, 2008 WL 1821877 (NY Sup Ct), *affd*, 59 AD3d 305 (1st Dept 2009) as guidance for its opinion here. There the court said:

> "Courts have often discussed the extent to which an instrument may require consultation with outside documents and still conform to the requirements of CPLR 3213 [*see Weissman v Sinorm Deli, Inc.*, 88 NY2d 437 at 444 (1996)] [the statute 'has generated a spate of litigation']. In this case, the instrument is a guaranty, which, by definition, relates to an underlying obligation. It requires the guarantor to perform the obligation of another, the primary obligor, so there must be some reference to another document.
>
> "The application of CPLR 3213 'is not affected by the circumstance that the instrument in question was part of a larger transaction, such as the sale of a business, as long as the instrument requires the defendant to make certain payments and nothing else' (*Torres & Leonard v Select Professional Realties, Ltd.*, 118 AD2d 467, 468 [1st Dept 1986]). A guaranty may be the proper subject of a motion for summary judgment in lieu of complaint whether or not it recites a sum certain, and the need to consult the underlying documents to establish the amount of liability does not affect the availability of CPLR 3213 (*European Am. Bank v Cohen*, 183 AD2d 453, 453 [1st Dept 1992] [amount readily ascertainable from bank records]; *see also European Am. Bank v Lofrese*, 182 AD2d 67, 71 [2d Dept 1992]; *Schwartz v turner Holdings, Inc.*, 139 AD2d 458, 459 [1st Dept 1998]). The failure to include all of the underlying documents with the motion does not necessarily render an instrument outside the purview of CPLR 3213 (*see Meyer v LaBarbera*, 35 AD3d 554, 555-556 [2d Dept 2006] [failure to include underlying promissory note]; *European Am. Bank & Trust Co. v Schirripa*, 108 AD2d 684, 684 [1st Dept 1985]).
>
> "An instrument that contains more than an unconditional promise to pay money is not necessarily disqualified as being for the payment of money only (*First Interstate Credit Alliance, Inc. v Sokol*, 179 AD2d 583, 684 [1st Dept 1992]). The 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 (*Juste v Niewdach*, 26 AD3d 416, 417 [2d Dept 2006]; *Stevens v Phlo Corp.*, 288 AD2d 56, 56 [1st Dept 2001]; *Machidera Inc. v Toms*, 253 AD2d 418, 418 [1st Dept 1999]; *Afco Credit Corp. v Boropark Twelfth Ave. Realty Corp.*, 187 AD2d 634, 634 [2d Dept 1992]). References to other agreements in the instrument do not necessarily qualify or alter the obligation to pay on the instrument (*Embraer Fin. Ltd. v Servicios Aereos*

Profesionales, S.A., 42 AD3d 380, 381 [1st Dept 2007] [instrument incorporated by reference the terms and conditions of the companion sale agreement only to the extent necessary for the enforcement of the note]; *Smith v Shields Sales Corp.*, 22 AD3d 942, 944 [3d Dept 2005]). A provision in the instrument that refers to another document for the definition of a term may be an instrument for the payment of money only (*see Boland v Indah Kiat Fin. [IV] Mauritius Ltd.*, 291 AD2d 342, 342-343 [1st Dept 2002] [instrument referred to indenture for definition of event of default]).

"In this case, the guaranty contains a straightforward unconditional promise to pay the money on the maturity date. That and defendant's acknowledgment of the amount owed constitute a prima facie case (*see Anthony M. Barraco, P.C. v Rosendale*, 162 AD2d 899, 900 [3d Dept 1990] [account stated and letter by defendant to plaintiff acknowledging debt constituted prima facie evidence of indebtedness]). The references to other documents do not prevent the guaranty from being enforceable as an instrument for the payment of money only. Those references to the underlying obligation do not add to or alter the guarantor's obligations. The other documents provide the necessary background to enforcing the guaranty, by establishing the amount owed, the interest rate, and the nature of the primary obligation. The guaranty does not obligate defendant to perform any provisions of the lease, except pay the mortgage/loan."

Accordingly, as the additional provisions present in the Guaranty do not require additional performance as a condition precedent to payment, and as the references to the underlying obligations do not add to or alter the guarantors obligations, the court is of the opinion that the Guaranty is an instrument for the payment of money only which is suitable for a CPLR 3213 motion for summary judgment in lieu of complaint.

Guaranty as Penalty

Defendant's next argument is summed up as follows:

"The Guaranty at issue here is no ordinary guaranty of payment. It is a creature of modern 'securitized' finance and the designation, customarily given to these instruments, speaks volumes on this point. Its official title is 'Guaranty of Recourse Obligations,' but within the industry it is more commonly referred to as a 'Good Boy' Guaranty, or, even more to the point: a '*Bad Boy*' Guaranty. . . .

"Under these instruments, while there is no liability initially, full liability will spring into existence, in the future, in the event the borrower acts as a 'bad boy' and takes any one of several enumerated 'bad' actions (files for bankruptcy, opposes a foreclosure, transfers collateral, etc.). The 'full recourse' provision makes no attempt to calculate the actual damage that might be suffered by the lender, as a result of the borrower's claimed 'bad actions"; rather, *ipso facto*, upon the happening of one of these 'bad' acts, the guarantor (a surety, secondarily liable) becomes liable for every cent of what is otherwise a fully non-recourse loan.

"That is to say, the 'Bad Boy Guaranty' – at its very core, and as the name suggests – seeks to punish and penalize so-called 'bad' actors who fail to perform, without ascertaining whether the complainant has even suffered any damages. Yet, for centuries now, throughout all common law jurisdictions, it has been settled law that contract provisions that are in terrorem, and attempt to punish and penalize, are void as a matter of cogent public policy and unenforceable.

Defendant's Memorandum of Law, pp 12-13.

The Guaranty here, which is irrevocable and absolute by its terms provides with respect to the assertion of defenses by the guarantor:

"1.3 Guaranteed Obligations Not Reduced by Offset. The Guaranteed Obligations and the liabilities and obligations of Guarantor to Lender hereunder shall not be reduced, discharged or released because or by reason of any existing or future offset, claim or defense of Borrower or any other party against Lender or against payment of the Guaranteed Obligations, whether such offset, claim or defense arises in connection with the Guaranteed Obligations (or the transactions creating the Guaranteed Obligations) or otherwise."

Plaintiff, in the first instance, citing *Onshore LLC v Sapir*, 2010 WL 5071785 (Sup Ct NY Nov. 2010),.*King v Wells Fargo Bus. Credit*, 48 AD3d 643, 644 (2d Dept 2008) and *Lehman Bros. Holdings, Inc. v Matt*, 34 AD3d 290 (1st Dept 2006) argues that the language of Section 1.3 waives Garrison's right to assert this defense. It is correct. Garrison is a sophisticated distressed real estate investor. The Guaranty, which is a lenders assurance against borrowers being permitted to take certain acts, is a common feature in commercial mortgage

loans. Such guarantees almost uniformly contain language which makes them unconditional and waives the right to assert defenses. Courts have upheld such features as valid financing arrangements. *See, Sapir*. Accordingly, the court is of the opinion that Garrison has waived the right to argue that the Guaranty constitutes an unenforceable penalty. However, in the interests of a full airing of plaintiffs' arguments, the court addresses plaintiffs assertion that the Guaranty is an unenforceable structured penalty.

Garrison was familiar with the Guaranty's mechanics and purpose of the Guaranty. It made a decision to take a calculated risk that it could arrange a refinancing of the Properties before being forced by an aggressive lender to initiate a bankruptcy proceeding to protect its economic interests. Such guaranties are recognized as legitimate financing arrangements with respect to real estate transactions and have been upheld in New York State and federal court. *See First Nationwide Bank v Brookhaven Realty Associates*, 233 AD2d 618 (2d Dept 1996), *appeal dismissed*, 88 NY2d 963 (1996); *Bank of Am., N.A., et al. v Lightstone Holdings, LLC & Lichtenstein Bank* (SDNY 2009); *Citigroup Global Mkts. Realty Corp. v Stern & Safrin*, No. 600824/09 (Sup Ct NY County 2009). Such features are not unenforceable penalties and plaintiffs reliance on *ING Real Estate Finance (USA) LLC v Park Avenue Hotel Acquisition LLC*, 2010 WL 653972 (NY Sup Ct 2010) is readily distinguished. There the court was dealing with the triggering of a guaranty by the filing of a tax lien, which was discharged during the cure period. The court found there that lender had not suffered damages during the brief period the lien was extant and declined to impose a deficiency judgment after foreclosure. Accordingly, the court finds the Guaranty here, in the circumstances, not to be an unenforceable penalty.

Public Policy

Garrison, without citing precedent, contends that the Guaranty is unenforceable, and against public policy, because it creates a conflict of interest between the guarantor's self-interest and the fiduciary duty that guarantor owes to borrower's creditors as the borrower edges toward insolvency. Garrison reasons as follows:

> "In the case of these "bad boy" guaranties, the guarantor typically is the principal of the borrower and, thus, is the individual making the determination and holding the authority to file bankruptcy on behalf of the borrower. Guaranties that attempt to impose massive liability upon the guarantor, for a borrower filing a bankruptcy petition, create a conflict of interest which could induce guarantors (in the exercise of their fiduciary duties as manager of the borrower) to refrain from filing the borrower into Chapter 11, to the detriment of the borrower's creditors and in breach of the manager's fiduciary duties to those creditors."

Defendant's Memorandum, p 19.

The court sees no distinction between this set of facts and those involving any parent corporate guaranty of debt of a subsidiary. The legitimacy of such common arrangements is not subject to question under any theory of commercial law of which the court is aware.

Finally, also without citing precedent, Garrison argues that the Guaranty is against public policy as it admits the possibility that an aggressive lender within a bank group will play "hold up" and insist upon sweetheart deals not available in bankruptcy. This, according to Garrison, is preventing the efficient restructuring of stressed mortgage debt and pushing real estate finance into a crisis position.

No doubt that there are many real estate developers who now regret having exposed themselves to the loss of fortune by investing in an overheated real estate market. Similarly, many lenders are now chagrined at the amount of non-performing assets on their balance sheets

due to their miscalculation of future demand for commercial real estate capacity. This, indeed, may have resulted in protracted negotiations between competing commercial interests which has led to clotting in the arteries of commercial real estate finance. The court is not equipped to know if this is so. However, the court is not a bank, insurance or pension fund regulatory authority with the administrative power required to address these circumstances. The court is an arbiter of commercial disputes, charged with upholding freely entered into contractual arrangements in accordance with common law precedents and the rules of legislative interpretation. It does not have a mandate to rewrite the rules relating to commercial real estate finance. If there is a need to address the present situation, it is the operation of a legislative or executive function that is called for. Accordingly, the court finds Garrison's public policy approach to be misdirected and without effect on this matter.

Accordingly, it is

ORDERED that plaintiffs motion for summary judgment pursuant to CPLR 3213 is granted.

Dated: March 8, 2011

ENTER:

J.S.C.