

Bouncing Back

January 28, 2021 | Issue No. 20

COVID-19 Update: Can't Lose What You Never Had: New York State Court Rejects Argument That a Pledge of the Equity Interests in an Entity That Owns Real Property Requires Foreclosure under RPAPL Article 13

During the COVID-19 pandemic, New York State courts have granted a number of preliminary injunctions enjoining UCC foreclosures for a period of time. For example, in *D2 Mark LLC vs. Orei VI Investments LLC and Shelbourne BRF LLC*, *Shelbourne 677 LLC v. SR 677 BWAY LLC*, the courts found that elements of the UCC foreclosures were not commercially reasonable as a result of the pandemic and temporarily prevented the UCC foreclosures.^[1] However, not all borrowers have had the same success with preliminary injunctions. In *893 4th Avenue Lofts LLC vs. 5AIF Nutmeg, LLC*, 893 4th Avenue Lofts LLC was the borrower (the "Borrower") under a loan secured by a pledge of its equity interests and the Borrower defaulted on its payment obligations under such loan. 5AIF Nutmeg, LLC, 5AIF Maple 2, LLC and 5 Arch Funding Corp. (collectively, the "Lender") sought to exercise their rights under the loan documents and to conduct a UCC sale. The Borrower and Michael Uhr, who signed the pledge and security agreement pledging the interests in the Borrower as collateral for the loan (collectively, the "Plaintiff"), sought to enjoin Lender from proceeding with the UCC sale. The Plaintiff argued that, because the sale affects land, the security agreement covered real property and, therefore, the UCC sale violated § 9-604 of the Uniform Commercial Code and the Lender was required to foreclose under Article 13 of the Real Property Actions and Proceedings Law.^[2] Section 9-604 of the New York UCC states, in part, that "[i]f a security agreement covers both personal and real property, a secured party may proceed . . . as to both the personal property and the real property in accordance with the rights with respect to real property. . . ."^[3] The Court rejected the Plaintiff's argument, noting that "[t]here is really no authority supporting the argument that ownership in an entity that owns property is considered an interest in real property" and went on to cite cases and sources which demonstrated that "foreclosing upon an interest in an entity that owns property does not implicate the real property itself. . . ."^[4] Therefore, because the case did not involve a foreclosure of real property, the Court denied the motion seeking an injunction and allowed the Lender to re-schedule the UCC foreclosure sale.^[5]

The New York State courts have demonstrated some sympathy towards borrowers and the struggles they have faced during the COVID-19 pandemic, as evidenced in the rulings relating to The Mark Hotel and the *Shelbourne* case, and lenders should continue to exercise caution in proceeding with UCC foreclosures in the State of New York while the pandemic continues. However, lenders should take comfort in the Court's ruling, which correctly upheld the status quo as it relates to UCC sales and shows that the courts are unwilling to entertain arguments that contradict settled law and practice even during a pandemic.

^[1] See Cadwalader's memorandum on The Mark Hotel UCC foreclosure, which is available at <https://www.cadwalader.com/resources/clients-friends-memos/the-mark-hotel-borrower-granted-injunction-delaying-mezzanine-lenders-foreclosure-sale>, and Cadwalader's memorandum on the Shelbourne UCC Foreclosure, which is available at <https://www.cadwalader.com/resources/clients-friends-memos/new-york-state-supreme-court-temporarily-halts-ucc-foreclosure-of-mezzanine-loan>.

^[2] *893 4th Avenue Lofts LLC v. 5AIF Nutmeg, LLC*, Index No. 511942/2020 (N.Y. Sup. Ct., November 25, 2020).

^[3] See U.C.C. § 9-604(a).

^[4] *893 4th Avenue Lofts LLC*, 511942/2020 at 2-3.

^[5] *Id.* at 5.