

New York State Supreme Court Temporarily Halts UCC Foreclosure of Mezzanine Loan

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On August 3, 2020, in *Shelbourne BRF LLC, Shelbourne 677 LLC v. SR 677 BWAY LLC*,^[1] the Supreme Court of the State of New York (the “Court”) granted the borrower plaintiffs’ motion for a preliminary injunction and prohibited the lender defendant from proceeding with a UCC foreclosure until October 15, 2020. This is the second decision in New York which halted or delayed a UCC foreclosure as a result of the COVID-19 pandemic. While the Court did not expressly refer to the earlier case which granted an injunction to D2Mark LLC on June 23, 2020, temporarily preventing the foreclosure of the indirect equity interests of the owner of the leasehold estate in The Mark Hotel^[2], the Court in *Shelbourne* reached a similar conclusion – that a UCC foreclosure may not be commercially reasonable and “that the equities of merely delaying the sale weigh in [the plaintiffs favor].”^[3]

Background

The plaintiffs own 100% of the equity interests in Shelbourne Broadway LLC and Shelbourne Albany LLC (the “Property Owners”) who, as tenants in common, own property known as 677 Broadway, Albany, New York (the “Property”). The Property Owners took out a mortgage loan secured by the Property (the “Mortgage Loan”) and the plaintiffs entered into a mezzanine loan with the defendants secured by 100% of the equity interests in the Property Owners. In May 2020, the Property Owners defaulted on the Mortgage Loan as a result of a missed payment. Shortly thereafter, and as a result of the missed payment of the Mortgage Loan, the defendants notified the plaintiffs that they would be proceeding with a UCC foreclosure sale, via video conference on July 20, 2020.^[4]

The Decision

While the plaintiffs brought a number of causes of action regarding the alleged default and the UCC foreclosure, the Court only reached a decision on the plaintiffs’ claim that they would suffer irreparable harm if the UCC foreclosure proceeded and declined to address the parties’ other arguments and issued a preliminary injunction on that basis.^[5] In reaching its decision, the Court noted that “[p]aragraph 7 of Administrative Order of the Chief Administrative Judge of the Courts dated July 23, 2020 (AO/157/20) provides ‘no auction or sale of property in any residential or commercial foreclosure matter shall be scheduled to occur prior to October 15, 2020.’”^[6] The Court extended that logic of the Administrative Order, which by its terms prohibits only mortgage foreclosure, to cover mezzanine foreclosures on the theory that the “valuation of the equity interests in a company that owns real estate is based on the value of the real estate itself.”^[7] The Court reasoned that as a result of the COVID-19 pandemic, valuations and consequently the bids received at a UCC foreclosure would be highly uncertain and therefore enjoined the defendants from proceeding with the UCC foreclosure until October 15, 2020. While a mezzanine foreclosure is clearly not a mortgage foreclosure, the Court ignored the legal distinction between a mezzanine loan and a mortgage loan.

Conclusion

While the Court did not provide guidance as to what could make a UCC foreclosure commercially reasonable during the COVID-19 pandemic, given the Court’s decision in *Shelbourne BRF LLC* and the June 23 injunction with respect to the mezzanine loan on The Mark Hotel, lenders should exercise caution in attempting to proceed with UCC foreclosures in New York State while the COVID-19 pandemic continues.

^[1] *Shelbourne BRF LLC, Shelbourne 677 LLC v. SR 677 BWAY LLC*, Index No. 652971/2020 (N.Y. Sup. Ct., August 3, 2020).

^[2] Cadwalader’s memorandum on The Mark Hotel UCC foreclosure is available at <https://www.cadwalader.com/resources/clients-friends-memos/the-mark-hotel-borrower-granted-injunction-delaying->

mezzanine-lenders-foreclosure-sale.

[3] *Shelbourne BRF LLC*, 652971/2020 at 1.

[4] Verified Complaint, *Shelbourne BRF LLC, Shelbourne 677 LLC v. SR 677 BWAY LLC*, Index No. 652971/2020 at 3-6.

[5] *Shelbourne BRF LLC* at 1, 2.

[6] *Id.* at 1 (*quoting* Administrative Order of the Chief Administrative Judge of the Courts dated July 23, 2020 (AO/157/20)).

[7] *Id.* at 1.