CADWALADER

Going Green

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Further Developments in Mezzanine Foreclosures

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The New York State Supreme Court, County of New York (the "Court") decided in *Atlas Brookview Mezzanine LLC v. DB Brookview LLC*, on November 18, 2021, that an accommodation pledge entered into in connection with a mortgage loan did not "clog" the borrower's equity right of redemption.

In an effort to avoid delays in mortgage foreclosure proceedings, many lenders have recently required, in addition to the borrower granting a mortgage on the real property, that the sole owner of such borrower pledge 100% of its equity interest in the borrower as additional collateral for a mortgage loan. This arrangement is usually structured by requiring the sole member of the borrower to enter into a guaranty agreement secured by a pledge and security agreement, and it is often referred to as an "accommodation" pledge. The accommodation pledge gives the lender the option to foreclose on the pledged equity interests through a UCC foreclosure sale (which can typically be completed within 60 to 90 days) instead of instituting a mortgage foreclosure proceeding (which in some jurisdictions can take longer than two years to complete).

Notwithstanding the increased use of the accommodation pledge structure by lenders, many legal practitioners remained uncertain that such structure could be enforced under New York law. Mainly, legal practitioners questioned whether an accommodation pledge (and lender's right to foreclose on such pledge) would not be enforceable because it clogged (or prevented) a borrower's right of redemption. The right of redemption is an equitable doctrine that allows a borrower to pay the full amount due to the lender, including principal, interest, and fees, to "redeem" the mortgaged property. The right of redemption generally cannot be waived, abandoned, or compromised before a default occurs. Under New York law, the right of redemption exists until the property sells in a mortgage foreclosure sale. Once the foreclosure sale is final, however, the borrower no longer has the right of redemption.

Although prior actions have been commenced in the state of New York by borrowers claiming that a UCC foreclosure sale based on an accommodation pledge violates the borrower's equitable right of redemption (see *HH Mark Twain LP v. Acres Capital Servicing LLC*[1], as an example), until the Court's decision in *Atlas Brookview Mezzanine LLC v. DB Brookview LLC*, New York courts have not directly ruled on whether an accommodation pledge clogs borrower's right of redemption.

Background

Atlas Brookview LLC ("Borrower") acquired a mortgage loan in the sum of $64,900,000 secured by real property located in the state of Illinois (the "Loan"). The loan documents entered into in connection with the Loan (other than the mortgage) were governed by New York law. The original lender required, as additional collateral for the Loan, that the sole owner of Borrower, Atlas Brookfield Mezzanine LLC, execute a guaranty secured by a pledge and security agreement whereby it pledged 100% of its interest in Borrower. The Loan was subsequently assigned by the original lender to DB Brookview LLC ("Lender").

Borrower defaulted on the Loan and Lender elected to foreclose on the accommodation pledge, and a UCC foreclosure sale was initially scheduled for August 25, 2020. Borrower thereafter commenced an action asking the Court to grant a temporary restraining order and a preliminary injunction to halt the UCC foreclosure sale, arguing that the accommodation pledge violated Borrower's equitable right of redemption.

The Court granted the temporary restraining order enjoining the Lender from conducting the UCC foreclosure sale prior to the expiration of the maturity date (*i.e.*, October 9, 2020), but did not grant the preliminary injunction, noting that the accommodation pledge did not violate Borrower's equitable right of redemption as Borrower still had the right to cure the default and redeem the Property under the UCC. Borrower thereafter failed to repay the Loan on the maturity date and a UCC foreclosure sale was conducted in February of 2021.

Borrower thereafter asked the Court for a declaratory judgement declaring that the accommodation pledge was "void" and asked the Court to undo the UCC foreclosure sale. Borrower maintained that the accommodation pledge was unenforceable as it had the effect of clogging borrower's equitable right of redemption by shortening the time Borrower would otherwise have to cure the defaults and redeem the Property had the Lender instead pursued a mortgage

foreclosure action. Notably, Borrower argued that an accommodation pledge would allow a Lender to conduct a "quick" UCC sale in as little as 30 days. Lender in turn filed a motion to dismiss Borrower's action.

Decision

The Court ultimately granted the Lender's motion to dismiss Borrower's action, concluding that the Borrower was a commercially sophisticated borrower represented by counsel and had voluntarily agreed to the loan structure requiring the accommodation pledge as additional collateral, hence allowing Borrower to later claim that such accommodation pledge was "void" and unenforceable and would be inconsistent with the agreement between the parties. In support of its decision, and in response to Borrower's argument that a UCC foreclosure sale was a quick UCC sale preventing Borrower from exercising its equitable right of redemption, the Court noted that, in this case, the UCC sale was not a "30 day sale" as notices of defaults, as well as the notice of disposition[2], were sent to the Borrower months before the maturity date and the scheduled UCC foreclosure sale and that Borrower could have paid off the Loan at any time prior to the UCC foreclosure sale.

Borrower has filed a notice of appeal in this case.

This decision provides comfort for many lenders who have structured their mortgage loans with accommodation pledges as additional collateral. While this case does specifically hold that there was no "clog" in the Borrower's rights of redemption, the Court again focuses on the fact that sophisticated parties, represented by sophisticated counsel, entered into a commercial transaction that the Court was loathe to overturn. New York is historically a very commercial jurisdiction, and there are many cases which hold again and again that sophisticated parties represented by sophisticated counsel will be held to the words of the documents they entered into. While in this case, the result was not favorable to the Borrower, it is favorable to the general principle that the election of New York for governing law is preferable as the courts will generally enforce the documents as written.

In the interest of full disclosure, Cadwalader represented the Borrower in this litigation.

We will continue to monitor these and other proposed legislation of interest and provide updates as needed.

[1] *HH Mark Twain LP v. Acres Capital Servicing LLC*, Index No. 656280/2019, 2020 N.Y. Misc. LEXIS 2515 (N.Y. Sup. Ct. June 2, 2020). Note: in *HH Mark Twain LP v. Acres Capital Servicing LLC,* the Court did not rule on Borrower's claim that Lender had unlawfully "clogged" the borrower's equitable right of redemption, but instead decided against borrower's motion for a preliminary injunction of the UCC foreclosure sale because the court found that borrower had failed to prove that they would suffer irreparable harm absent the preliminary injunction.

[2] The notice of disposition describes the debtor, the secured party and the collateral to be disposed of; states the method of disposition and that the debtor is entitled to an accounting of the unpaid obligations for a stated fee; and provides the time and place of a public sale or the time after which any other disposition is to be made.

Green Loans Series, Part 1 – Green Loans and the Green Loan Principles

February 28, 2022

By **William Lo**
Associate | Real Estate

In our January edition of *REF News and Views*, we discussed some key recent **ESG developments in Europe and the UK** in the financial markets. We want to follow this up over the coming months with a series of articles where we consider ESG further by delving deeper into the emergence of "green loans" and the Green Loan Principles − those principles that seek to form the framework of market standards, guidelines and methodology to be adopted across the green loan market.

Ultimately, as the world moves towards a greener, more sustainable future, lenders and corporates in the UK are becoming more conscious of their impact on climate change and the environment through their investments and lending activity. This is in part due to the greater levels of regulation and accountability being imposed by the government in respect of sustainability, as well as an overall increased awareness of the issues shrouding climate change and the environment. This has led to the inception of the concept of green loans and the Green Loan Principles to help act as a roadmap towards sustainable investing and to align the financial system with the UK's ambitious net-zero commitments.

What is a green loan?

A "green loan" is not a clearly defined or regulated term, but is often used in the financial markets as a general term to describe loans made with the view of green and sustainable lending. This can be reflected by way of the underlying green project investment, the management of the proceeds, and reporting, but is otherwise linked to the use of the proceeds of the loan towards an eligible green project.

It is worth noting that a sustainability linked loan ("SLL") should be differentiated from a green loan. An SLL focuses on the behaviour of the borrower as opposed to the project itself, in which the loan will be designed to incentivise the borrower to meet certain key performance indicators that are based on sustainability and a commitment to reducing environmental impact. These could include commitments that relate to energy efficiency and the sourcing and use of sustainable materials and supplies. We will discuss SLLs in more detail in future articles.

The Green Loan Principles

In March 2018, the Loan Market Association ("LMA") first published its Green Loan Principles ("GLP"), which seek to facilitate and support environmentally sustainable economic activity by providing a framework of market standards, guidelines and methodology that can be consistently adopted across the green loan market. The LMA continues to update the GLP, with the latest version being published in February 2021 where it included social risks as one of the categories to consider during project evaluation.

When should the GLP be applied?

Whilst the GLP are recommended for green loan products, they are currently still voluntary and for guidance only, aimed to be applied by market participants on a deal-by-deal basis depending on the underlying characteristics of the transaction. It is therefore incumbent on the lenders to define their internal standards with regards to eligibility criteria for what they would classify as a green project.

This being said, there are an increasing number of national and international measures and initiatives being discussed, created and imposed on corporate governance, climate change and sustainability that are starting to change how companies and the financial markets are operating and approaching their businesses. As such, with increasing socioeconomic pressures, we fully expect to see a continued growth in the use of GLP as the guiding core principle for green loan products, as well as an evolution and development in the GLP, over the coming years.

To qualify as a GLP-compliant green loan, such loan product must align itself with the following four core components:

- Use of proceeds
- Process for project evaluation and selection

- Management of proceeds
- Reporting

We will discuss each of the four core components in more detail in next month’s edition of *REF News and Views*.

Law360 Practice Group of the Year: Hospitality

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Leading legal industry publication *Law360* recently recognized Cadwalader as a "Practice Group of the Year" for hospitality.

Cadwalader's hospitality industry work is done largely through the firm's 50-lawyer real estate team, with its specialized knowledge of transactions in the hospitality industry as well as across all sectors of the real estate market.

Real Estate Finance chair Bonnie Neuman talked with *Law360* about a number of key hospitality industry transactions over the past year: the $4.65 billion securitized financing that helped pay for The Blackstone Group and Starwood Capital Group's $5.94 billion acquisition of Extended Stay and its affiliated real estate investment trust, ESH Hospitality Inc.; JPMorgan Chase's $158.4 million construction loan for the development of Great Wolf Lodge & Waterpark Resort; and the $450 million refinancing of the Hyatt Regency Waikiki Beach Resort and Spa in Honolulu.

All in all, Neuman said the group saw “quite a bit of activity in public-to-private transactions in 2021, which we hadn't seen in 2020. There was definitely pent-up demand. There are still challenges in the hospitality market, but I think that activity will continue."

You can access the *Law360* story **here**.

Cadwalader Shortlisted in Real Estate Capital USA Inaugural Awards

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Cadwalader has been shortlisted as one of just four law firms in an inaugural awards **program** from *Real Estate Capital USA*, which will acknowledge the organizations and deals that "best represented the U.S. real estate debt market" in 2021.

As examples of the Real Estate Finance team's recent high-profile work, *Real Estate Capital USA* points to Cadwalader's lender representations in connection with the $3 billion single-asset/single-borrower ("SASB") ESG-driven securitized refinancing of the One Vanderbilt skyscraper in Midtown Manhattan and the $4.65 billion SASB securitized financing as part of the $5.94 billion privatization of Extended Stay by The Blackstone Group and Starwood Capital Group.

The full list of nominees across all categories, which is open to voting through February 28, is available **here**.

Cadwalader's Real Estate team, with attorneys based in New York, London and Charlotte, applies its expertise to the complete spectrum of real estate transactions, including financings, acquisitions, sales and exchanges, development, construction, joint ventures, loan syndications and participations, management, and leasing.

Real Estate Capital USA, a publication of PEI Media that launched in 2021, provides analysis of the U.S. commercial real estate debt markets.

Recent Transactions

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Here is a rundown of some of Cadwalader's recent work on behalf of clients.

- Represented the lender in a $45 million junior mezzanine construction loan and profit participation for the completion of two multifamily properties located in Irvine, California.
- Represented the lender in a $59.4 million mortgage loan providing future advances to fund upgrades to a multifamily property located in Norcross, Georgia.
- Represented the lender in a $355 million mortgage loan for 19 office and mixed use properties located in multiple states.
- Represented the lender in a $230 million loan secured by movie studio property in Yonkers, New York.
- Represented the lender in a $130 million mortgage loan of acquisition financing for five buildings in an interior design and showroom space located in Dallas, Texas.
- Represented the lenders in the $1.195 billion acquisition financing of 111 WoodSpring Suites hotel properties across the United States by a joint venture between Blackstone and Starwood Capital, demonstrating a continued interest in the extended stay hotels sector of the industry.