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The Mark Hotel Borrower Granted Injunction Delaying Mezzanine Lender's Foreclosure Sale

By Melissa C. Hinkle, Christopher J. Dickson, Nathan Bull, and Howard R. Hawkins Jr.*

The authors of this article discuss a recent preliminary injunction granted in favor of a borrower enjoining the mezzanine lender from proceeding with a Uniform Commercial Code foreclosure sale of the equity interests in The Mark Hotel.

The Supreme Court of the State of New York, County of New York: Commercial Division has issued a preliminary injunction in favor of the plaintiff D2Mark LLC (the "Borrower") enjoining the defendant, OREI VI Investments LLC (the "Mezzanine Lender") from proceeding with a Uniform Commercial Code ("UCC") foreclosure sale of the equity interests in The Mark Hotel for 30 days. The court found many of the terms of the sale to be not commercially reasonable, as required under the New York UCC, and the current COVID pandemic exacerbated the defects in the Mezzanine Lender's actions, resulting in the court granting the request for an injunction. As a result of this decision granting a borrower, and subjecting a lender to, an injunction on the sale of certain loan collateral, and notwithstanding the unique facts and circumstances of this particular case, a common loan document provision may require revision in order to avoid or mitigate against such risk of injunction.

BACKGROUND

The Mezzanine Lender is the holder of a non-recourse mezzanine loan in the amount of $35 million made to the Borrower (the "Loan"). To secure the Loan,

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the Borrower pledged to the Mezzanine Lender the Borrower's membership interest in D2 Mark Sub LLC (the "Collateral"), a subsidiary of the Borrower indirectly owning leasehold estates in The Mark Hotel, located on Madison Avenue and East 77th Street in New York City. Following certain monetary and material non-monetary events of default under the Loan,[1] the Mezzanine Lender gave notice to the Borrower on May 18, 2020, pursuant to the New York Uniform Commercial Code ("New York UCC"), of a sale of the Collateral to be held on June 24, 2020 (i.e., 36 days from the notice of sale).

On June 6, 2020, the Borrower sought an injunction to stay the auction until August 18 or 19, 2020, alleging, in part, that the sale process was not commercially reasonable and in particular, that certain executive orders in effect due to the pandemic were relevant, and should be considered by the court in this case. In determining whether or not to grant a preliminary injunction, the court applied the familiar three-part test that requires the movant to establish:

(1) A likelihood of success on the merits of the action;

(2) The danger of irreparable harm in the absence of a preliminary injunction; and

(3) A balance of the equities in favor of the moving party.[2]

THE COURT'S DECISION

The UCC requires that "every aspect of a disposition of collateral, including the method, manner, time, place, and other terms, be commercially reasonable."[3] In finding that the Borrower had shown a likelihood of success on the merits of the claim that the sale process was not commercially reasonable, the court identified several deficiencies. First, the notice period was very short—just 36 days. The court observed that the Borrower submitted affidavits opining that typical UCC foreclosures on complex commercial real estate assets would typically take 60 to 90 days. In addition, The Mark Hotel was closed for 27

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[1] The original financing on The Mark Hotel consisted of a $230 million mortgage loan (the "Mortgage Loan") and the Loan. The May interest payment owed by the Borrower to the Mezzanine Lender on May 1, 2020 was paid late on May 8, 2020, but without the payment of default interest or late charges which accrued on such late payment. The monthly payments owed on the Mortgage Loan for the months of April and May were not paid (the "Mortgage Loan Monetary Default"), which caused a cross-default under the Loan. The Mezzanine Lender advanced cure payments in the amount of $2.2 million to the holder of the Mortgage Loan to cure the Mortgage Loan Monetary Default, which amounts were not repaid by the Borrower.

[2] *W.T. Grant Co. v. Srogi,* 52 N.Y.2d 496, 517 [1981].

[3] *See* U.C.C. § 9-610(b).

days of the 36-day window due to the COVID-19 pandemic, which prevented potential buyers from doing their due diligence of the asset. Second, the sale process was structured to exclude or minimize the number of third-party bidders. For instance, a 10 percent deposit of the sale price was required at bidding, with the remaining 90 percent to be provided within 24 hours after closing of the sale process. Third, contact with the Borrower by potential bidders was limited, and the Borrower itself was initially precluded from bidding.[4] It is important to note that had the Mezzanine Lender acted more reasonably in structuring the sale, both in what is generally required for such a sale to be considered "commercially reasonable" under the New York UCC and with consideration to certain practical constraints resulting from the COVID-19 pandemic, it is possible and maybe likely that this request for an injunction would have been denied.

Having found the first prong of the preliminary injunction test satisfied, the court considered if irreparable harm would occur in the absence of granting the injunction. In doing so, the court cited as a material factor a common provision in the underlying loan documents for the Loan (which is included in full below) that limits the Borrower's remedies. The court held that because "the parties agreed to limit [P]laintiff's remedies to injunctive relief; money damages are not available to [P]laintiff here. *Such a provision is enough to establish irreparable harm.*"[5]

Typically, this type of provision is intended and understood to apply to a situation where the lender has delayed or withheld its consent to a request by a borrower pursuant to the terms of the loan documents where the lender is required to act in a reasonable fashion in granting or withholding such consent. It is intended to protect the lender from claims seeking monetary damages in such a situation.[6] Instead, in this case, the court applied the provision to the Mezzanine Lender's conduct in its exercise of remedies. This is one reason why the outcome in *D2Mark* is unexpected and likely avoidable.

Historically, satisfying the "irreparable harm" component of the preliminary injunction test has been difficult for borrowers seeking injunctive relief because an investment loss can typically be remedied by monetary damages.[7] Because

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[4] The Mezzanine Lender reversed this restriction on the Borrower on June 8, 2020.

[5] *See* Page 11 of decision, emphasis added.

[6] For instance, if a lender is subject to a claim of monetary damages for unreasonably not approving a lease, the potential damages to be claimed could be substantial, thereby chilling the ability of a lender to objectively disapprove of a lease in the face of a potential monetary damages claim.

[7] *See e.g., Broadway 500 W. Monroe Mezz II LLC v. Transwestern Mezzanine Realty Partners*

the court found the contractual prohibition on monetary damages dispositive in showing irreparable harm, we recommend that lenders consider revising any similar provision on the limitation of remedies that is in their form loan documents, perhaps with these changes:[8]

> *Except in connection with any action or claim arising out of any exercise of remedies by Lender following an Event of Default*, in the event that a claim or adjudication is made that Lender or its agents have unreasonably delayed acting in any case where by law or under this Agreement or the other Loan Documents, Lender or such agent, as the case may be, has an obligation to act reasonably or promptly, Borrower agrees that neither Lender nor its agents shall be liable for any monetary damages, and Borrower's sole remedies shall be limited to commencing an action seeking injunctive relief or declaratory judgment. *For the avoidance of doubt, this limitation on remedies of Borrower shall not apply to any claim by Borrower that Lender has failed to conduct any foreclosure or other exercise of remedies in accordance with the Uniform Commercial Code or other applicable law.*

CONCLUSION

Lenders always are bound by the common-law implied duty of good faith and fair dealing under any contract governed by New York law, but readers should note that the adoption of the recommended changes do open up the possibility that the lender may now be subject to a claim for monetary damages for alleged unreasonable actions that occur post-event of default. Lenders will need to balance whether or not the ability to realize on the collateral with a reduced possibility of a court granting injunctive relief to the borrower outweighs the risk of a potential post-default monetary claim by the borrower. It remains to be seen whether or not *D2Mark* will be a case of limited applicability to mezzanine financing or whether the court construed the contractual limitation on remedies in the manner which it did because the conditions to the sale were not commercially reasonable.

II, LLC, 80 A.D. 3d 483 (1st Dep't 2011); *Atlas MF Mezzanine Borrower, LLC v. Macquarie Texas Loan Holder LLC*, 174 A.D. 3d 150 (1st Dep't 2019).

[8] This excerpt is from the Mezzanine Loan Agreement in *D2Mark LLC v. OREI VI Investments LLC*.