

Clients & Friends Memo

Further Developments in Mezzanine Foreclosures

April 26, 2022

The New York State Supreme Court, New York County Commercial Division (the “Court”) decided in *U.S. Bank, N.A. v. 342 Property LLC*,¹ on February 14, 2022, that a mezzanine lender that is not a party to loan documents that evidence a concurrent mortgage loan does not have standing and, therefore, no basis, to preclude a mortgage lender’s motion for summary judgement in a foreclosure action against a mortgage borrower that is an affiliate of a mezzanine borrower.

Background

342 Property LLC (the “Mortgage Borrower”) received a \$40,000,000.00 mortgage loan (the “Mortgage Loan”) secured by real property located in New York State and the hotel located thereon (collectively, the “Property”). The Loan was evidenced by a mortgage, promissory note, and other loan documents governed by New York law (the “Mortgage Loan Documents”) in favor of U.S. Bank National Association, as trustee for Mortgage Stanley Capital I Inc. (the “Mortgage Lender”), by assignment from a previous lender.²

Additionally, Mortgage Borrower’s parent company (“Mezzanine Borrower”) received from Axonic Credit Opportunities Master Fund, L.P. (the “Mezzanine Lender”) a \$16,000,000.00 mezzanine loan (the “Mezzanine Loan”) secured by a pledge of membership interests in Mortgage Borrower and evidenced by loan documents governed by New York law (the “Mezzanine Loan Documents”).

Concurrently, Mortgage Lender and Mezzanine Lender entered into an intercreditor agreement, dated May 21, 2015, which established, *inter alia*, Mezzanine Lender’s right to pay off the Mortgage Loan, conduct a UCC sale, and pursue recourse claims against Mezzanine Borrower to the extent that Mezzanine Borrower defaulted under the Mezzanine Loan Documents.³

Subsequently, Mortgage Borrower failed to pay the amounts then due and owing under the Mortgage Loan and defaulted under the Mortgage Loan Documents, ostensibly having suffered

¹ *U.S. Bank N.A. v. 342 Prop. LLC*, 2022 N.Y. Slip Op. 30488(U).

² Complaint, dated October 08, 2020, Index No. 655136/2020 (Dkt. No. 2).

³ Decision and Order on Motion Seq. 005, dated February 14, 2022, Index No. 655136/2020 (Dkt. No. 189).

financial hardship resulting from COVID-19 restrictions.⁴ After Mortgage Borrower and its affiliates agreed not to contest a foreclosure action in exchange for Mortgage Lender agreeing not to seek recourse against Borrower's principals, Mortgage Lender then brought a foreclosure action against Mortgage Borrower for failure to pay the Loan under the terms of the Mortgage Loan Documents.

The Mortgage Lender moved for summary judgment against the Mortgage Borrower in the underlying foreclosure action. Mezzanine Lender then asserted that Mortgage Borrower agreeing to allow Mortgage Lender to bring the instant foreclosure action and the appointment of a receiver constituted a default under the Mezzanine Loan Documents and adversely affected Mezzanine Lender.⁵

The Court reviewed the Mortgage Lender's motion for summary judgment to determine, absent any material facts in dispute, whether Mortgage Lender's foreclosure claim may be decided as a matter of law.

Decision

Deciding in favor of Mortgage Lender, the Court granted Mortgage Lender's motion for summary judgment and held that Mezzanine Lender had "no basis to contest the Mortgage Lender's right to foreclose" on the Property.⁶ That is, the Court held that Mezzanine Lender was not a party to the Mortgage Loan Documents and held no interest in the Property. As such, absent an agreement between Mortgage Lender and Mezzanine Lender providing otherwise, Mezzanine Lender lacked standing to assert claims or defenses against the instant motion.

The Court's decision in *U.S. Bank, N.A. v. 342 Property LLC* reaffirms the established principle that a mezzanine lender's recourse is subject to a mortgage lender's rights and defenses against an affiliate mortgage borrower that subsequently defaults under the mortgage loan, which also constitutes a default under the mezzanine loan.

We will continue to monitor future developments in this area and advise accordingly.

⁴ Decision and Order on Motion Seq. 005, dated February 14, 2022, Index No. 655136/2020 (Dkt. No. 189).

⁵ Axonic Credit Opportunities Master Fund, L.P.'s Memorandum of Law in Opposition to Motion for Summary Judgment (Mot. Seq. 005), dated October 26, 2021, Index No. 655136/2020 (Dkt. No. 167).

⁶ See *supra* fn. 4.

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If you have any questions, please feel free to contact any of the following Cadwalader attorneys.

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