To Our Clients and Friends

Memorandum

June 24, 2020

First New York UCC Foreclosure Halted By A Preliminary Injunction—The Mark Hotel

In a significant decision that appears to be the first case that goes against the well-established line of New York cases denying preliminary injunctions preventing UCC foreclosure sales, a New York County Supreme Court judge halted a UCC foreclosure auction by issuing a preliminary injunction in favor of the mezzanine borrower in *D2 Mark LLC v. Orei VI Investments LLC* (Index No. 652259/20) (the "Action"), which involved a foreclosure of the ownership interests in the Mark Hotel.

The Action was commenced by a mezzanine borrower seeking to prevent its mezzanine lender from conducting a UCC foreclosure auction on the basis that the sale process was not "commercially reasonable." The New York UCC provides that every aspect of a disposition of collateral, including the method, manner, time, place and other terms of the sale, must be commercially reasonable. N.Y. U.C.C. § 9-625. The mezzanine borrower had failed to pay the senior loan because of significant financial hardship as a result of the COVID-19 pandemic, which effectively shuttered the Mark Hotel, and triggered a cross-default under the mezzanine loan. The mezzanine borrower tried to negotiate a forbearance with the mezzanine lender, but during those negotiations, the lender gave 36 days' notice that it was conducting a UCC foreclosure of the borrower's collateral.

The borrower commenced the Action seeking injunctive relief to prevent the auction from being held at the scheduled time, alleging that the procedures of the sale were not commercially reasonable and that the lender's sale was a "predatory attempt to capitalize on the COVID-19 pandemic." The borrower alleged that they were precluded from bidding, that 36 days was too short of a sale process in light of the COVID-19 pandemic, that the sale was not crafted to comply with the "stay at home" orders in New York City, and that due diligence was significantly hampered by those "stay at home" orders. The Court found these arguments persuasive, and found that the borrower had sufficiently demonstrated that the proposed foreclosure sale may not be commercially reasonable. Additionally, although the lender argued that the sale process was demonstrably reasonable because they had received 115 NDAs, the Court found the lender's argument unpersuasive in light of the fact that only *two* bidders had pre-qualified for the auction.

What makes the *D2 Mark* case unique is the Court's finding that the borrower had established that they would suffer irreparable injury in the absence of an injunction, but the finding was based on a provision in the loan agreement that limited the plaintiff's remedies to injunctive relief in the event that the lender acted unreasonably. While most lenders' counsel would have viewed the clause as limited to instances in which the lender had unreasonably refused to grant consent, the Court interpreted this provision to establish irreparable injury because damages were unavailable. Traditionally, the "irreparable injury" standard in New York has been the biggest hurdle for mezzanine borrowers seeking to enjoin a UCC sale of their membership interests. The well-established rule in New York in these cases is that "[s]ince

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plaintiffs' interest in the real estate is commercial, and the harm they fear is the loss of their investment, as opposed to loss of their home or a unique piece of property in which they have an unquantifiable interest, they can be compensated by damages and therefore cannot demonstrate irreparable harm."[1] The Court did not find this line of authority persuasive because the parties' agreement precluded the borrower from obtaining monetary damages.

Finally, the Court held that the balancing of equities favored the mezzanine borrower. The Court held that the plaintiff would be deprived of not only its sole asset, but ownership and control rights in the plaintiff's wholly owned subsidiaries that own, operate, and manage the property. The Court found that this loss of control would also eliminate the plaintiff's ability to control public perception of the name of the property and the trademark rights in the hotel, which further established the plaintiff's irreparable harm if the sale were to go ahead.

Ultimately, the Court ordered that the sale would be stayed for 30 days, and directed the lender to re-notice the sale and develop a plan for a commercially reasonable sale. We will be monitoring further developments in this case with interest.

The mezzanine borrower also sought a declaration from the Court that the foreclosure would violate the recent executive order signed by New York Governor Andrew Cuomo (Executive Order Number 202.8) (the "Executive Order"), which stayed all residential and commercial evictions and foreclosures. The Court did not consider whether the foreclosure was barred by the Executive Order, but noted that executive orders are persuasive authority that "what is reasonable during normal business times, may not be reasonable during a pandemic." An earlier New York State court decision from a different judge had ruled that the Executive Order does not prohibit UCC foreclosures. *See* Fried Frank Client Memorandum, New York State Court Gives UCC Foreclosures the Go Ahead (May 18, 2020).

Please contact us if you are interested in this decision, or if you require any advice relating to any of the matters covered in this alert.

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[1] *See, e.g., Broadway 500 W. Monroe Mezz II LLC v. Transwestern Mezzanine Realty Partners II, LLC*, 80 A.D.3d 483, 484 (1st Dep't 2011); *accord Atlas MF Mezzanine Borrower, LLC v. Macquarie Texas Loan Holder LLC,* 174 A.D.3d 150, 156 (1st Dep't 2019).

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This memorandum is not intended to provide legal advice, and no legal or business decision should be based on its contents. If you have any questions about the contents of this memorandum, please call your regular Fried Frank contact or an attorney listed below:

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