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One of These Things Is Not Like the Other: New York State Court Upholds Commercial Reasonableness of Mezzanine Sale

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On November 10, 2021, the owner of the State Street Financial Center in Boston, Massachusetts defaulted on its debt, consisting of a mortgage loan in the amount of $535,000,000 and three mezzanine loans in the aggregate amount of $350,000,000. The day after the loans defaulted, the second mezzanine lender (the "Defendant") sent a notice for the sale of the collateral securing its loan, which was a pledge of the equity interests in an indirect owner of the property (the "Plaintiff"), and the sale was subsequently scheduled for December 20, 2021. The third mezzanine lender also scheduled a mezzanine sale for December 21, 2021. The Plaintiff filed a motion in the Supreme Court of the State of New York looking to stay the foreclosure, arguing that the mezzanine sale was not commercially reasonable and that it would suffer irreparable harm if the mezzanine foreclosure proceeded because it would lose its property and monetary damages would not be insufficient. [1]

Section 9-627(b) of the New York Uniform Commercial Code states that "[a] disposition of collateral is made in a commercially reasonable manner if the disposition is made . . . in conformity with reasonable commercial practices among dealers in the type of property that was the subject of the disposition."[2] The Plaintiff argued that the Defendant failed to meet this standard because, among other things, (1) the timeline was complicated by Christmas and New Year's resulting in decreased attendance and chilled bidding at the foreclosure sale, and (2) the Defendant was seeking to "rush" the sale to take place one day prior to the scheduled sale of the most junior mezzanine lender and that this would create confusion for the bidders.[3] The court quickly disposed of the argument about the holidays, emphasizing that the notices were publicized on November 11, 2021 and stating that "[t]he mere fact the actual sale is a few days before a holiday and might interfere with an overarching and extended holiday season does not mean the sale is commercially unreasonable as a matter of law....[D]etailed information about vacation habits, flight availability and reduced work hours do not have any

bearing on notices sent in early November. To argue otherwise would virtually eliminate most of the year as appropriate for scheduling a sale…."[4] The court was equally as dismissive of Plaintiff's argument that the most junior mezzanine lender's foreclosure scheduled for the day after the Defendant's sale would create confusion for the bidders because, for example, they could assume that the Defendant's notice of sale was just a re-noticing of the other lender's sale. The court stressed the sophistication of the parties involved, noting that "only a sophisticated bidder would be interested in such an expensive property," that such bidders would be "extremely well counseled" and that it was "difficult to imagine a sophisticated bidder…could make such elementary and easily verifiable mistakes."[5]

After the discussion on the commercial reasonableness of the sale, the court switched gears and examined the Plaintiff's argument that it would suffer irreparable harm if Defendant were to proceed with the foreclosure because the foreclosure would "result in a loss of property which cannot be replaced with any monetary damages."[6] The opinion detailed the differences between owning and operating real property and owning an equity interest in another entity and the fact that a mezzanine loan is secured by a pledge of equity interests rather than a mortgage on real property. The court then went on to unequivocally state that an entity which owns equity in the owner of real estate does not own real property, noting that "[t]here are no cases that hold that ownership interest in such an entity is the equivalent of an ownership interest in real property sufficient to render the interest unique and thereby entitle the party to injunctive relief."[7]

The court in this case understood the fundamental differences between mortgage and mezzanine loans and maintained the status quo with respect to foreclosure of mezzanine loans. Mezzanine lenders who make large loans to sophisticated parties should be particularly pleased with this ruling given that this case involved a significant and well-known property and the court gave great weight to the sophistication of the parties when determining whether or not the notice of the foreclosure sale was commercially reasonable.

There have been quite a number of decisions over the past few years addressing mezzanine enforcement and borrower's efforts to thwart the lender's exercise of remedies. Suffice it to say that, while there have been some delays due to COVID, the courts have been very "commercial" in upholding lender's rights and remedies. We will continue to monitor this area and provide updates as they arise.

[1] *Lincoln St. Mezz II LLC v. One Lincoln Mezz 2 LLC*, Index No. 530492/2021 (N.Y. Sup. Ct., December 8, 2021).

[2] U.C.C. § 9-627(b).

[3] *Lincoln St. Mezz II LLC*, Index No. 530492/2021 at 2.

[4] *Lincoln St. Mezz II LLC*, Index No. 530492/2021 at 4.

[5] *Id.* at 3.

[6] *Id.* at 5.

[7] *Id.*