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Real Estate Workout Advisory

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Defendants' Out-of-State Real Estate Partnership Interests Attachable in New York

In a recent decision, in *Hotel 71 Mezz Lender LLC v. Falor*,[1] the New York Court of Appeals affirmed a pre-judgment order attaching defendants' membership interests in out-of-state limited liability companies, reasoning that defendants' intangible ownership interests followed them, and were attachable in New York because defendants had agreed to personal jurisdiction in New York. This decision could become a powerful tool for plaintiff lenders seeking to attach a defendant's intangible property (e.g., equity interests in a partnership owning real estate assets).

Background

In 2005, Hotel 71 Mezz Lender LLC made a $27 million mezzanine loan to borrower Chicago H & S Senior Investors, LLC for the purpose of developing a hotel in Chicago. Six individual defendants, none of whom live in New York, executed a guaranty under which they agreed to be jointly and severally liable for the borrower's obligations under the loan.

The loan was negotiated in, and all of the proceeds of the loan were disbursed from, New York. In addition, the guaranty was governed by the laws of New York State, and the guarantors submitted to the jurisdiction of any court in New York for any proceeding relating to the loan.

In 2007, after the borrower defaulted on the loan and filed for bankruptcy protection, the lender sued the individual guarantors in New York County Supreme Court. The lender obtained an *ex parte* prejudgment order of attachment pursuant to New York Civil Practice Law and Rule ("CPLR") Article 62. The property attached included defendants' intangible and "uncertificated" interests in twenty-two limited liability companies formed outside of New York.

One defendant appeared in the New York Supreme Court to be deposed, and to oppose the order of attachment. Following the hearing, the Supreme Court authorized the Sherriff to serve the order on the defendant as garnishee for the defendants' interests in the out-of-state entities and as apparent manager of the entities.

In a 3-1 decision, the Appellate Division reversed, holding that the Supreme Court lacked jurisdiction over the defendants' out-of-state intangible and "uncertificated" interests.

The Court of Appeals Affirmed the Order of Attachment

The Court of Appeals reversed the Appellate Division and affirmed the pre-judgment order of attachment.

First, the Court held that "a court with personal jurisdiction over a nondomicillary present in New York has jurisdiction over that individual's tangible and intangible property, even if the situs of the property is outside New York." In this case, because the individual defendants had voluntarily submitted to personal jurisdiction in New York by executing the loan guarantee, the "Supreme Court had the authority to order pre-judgment attachment of the property [the] defendant owned and/or controlled, and service of the

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order on him while he was in New York was appropriate."

In reaching this conclusion, the Court distinguished between two purposes for attaching property. If New York does not have personal jurisdiction over a defendant and the purpose of attaching property is to establish *quasi in rem* jurisdiction, the property must be in New York. If, however, a court already has personal jurisdiction over a defendant and the purpose of attaching property is only to provide pre-judgment security—that is, to ensure there would be sufficient money to satisfy a judgment if plaintiff prevailed—then the property need not be in New York.

Second, in what appears to be dicta, the Court noted that the Appellate Division had mistakenly relied on *National Broadway Bank*, a 1904 opinion in which the Court of Appeals had held that the situs of intangible property is the domicile of the debtor. *National Broadway Bank* was overruled in 1905 by the United States Supreme Court in *Harris*, which held that the situs of a debt (a form of intangible property) "clings to" and "accompanies" a debtor wherever he goes. The Court held that, under *Harris*, if a debtor is already subject to the court's personal jurisdiction, "the situs of the debt is wherever the debtor is present." Applying *Harris*, the Court concluded that the situs of a defendant's intangible interests traveled with him when he came to New York "and were attachable in New York based on his presence [in] this state."

The court did not reach the question of whether a court may attach the intangible property of a defendant who travels temporarily to the state for the limited purpose of appearing in another action, and thus is not otherwise subject to the jurisdiction of New York.

Conclusion

As a general matter, pre-judgment attachment of a defendant's interests in property is a difficult interim remedy to achieve in the New York courts. Even more so if the property being attached is located outside of New York. However, the *Hotel 71* case shows that under the right circumstances, not only might lenders prevail, but they may prevail against even intangible equity interests in real estate ownership entities, even if the real estate held by those entities are located outside of New York.

In time, additional decisions by the lower courts should clarify the scope of *Hotel 71 Mezz Lender LLC*. In the meantime, plaintiff lenders should recognize that the decision may give them the ability to attach intangible property, such as interests in real estate owning partnerships and LLC's, located outside of New York. Defendants, on the other hand, should tread carefully. A defendant would be well advised to consider that, when submitting himself to jurisdiction in New York, in a Guarantee, Note or other loan documents, he may also be submitting his intangible property to the jurisdiction of the New York courts.

If you have any questions relating to this court decision, or the jurisdictional issues raised by the decision, please do not hesitate to contact Morrison & Foerster's Distressed Real Estate Group.

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[1] *Hotel 71 Mezz Lender LLC v. Falor,* No. 9 (N.Y. Feb. 16, 2010).

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