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Real Estate Workout Advisory

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Recent Victory for Senior Lender in Stuyvesant Town Case

"Tranche Warfare" Continues

On September 16, 2010, the New York State Supreme Court issued a preliminary injunction preventing the most senior mezzanine lender in the Peter Cooper Village/ Stuyvesant Town financing from foreclosing on its "equity collateral" unless it simultaneously repaid the entire outstanding principal and interest on the senior CMBS mortgage loan. The Court's ruling was based on interpretation of key provisions of the intercreditor agreement entered into between the senior and mezzanine lenders. Since these intercreditor provisions are typical in real estate finance, the Court's opinion will undoubtedly attract significant interest among industry players.

Tishman Speyer Development Corp. financed its $5.4 billion purchase of the Peter Cooper Village and Stuyvesant Town property with a $3 billion senior CMBS mortgage loan and a total of $1.4 billion of mezzanine loans, secured by direct or indirect equity pledges in the senior CMBS borrowers. In January 2010, the CMBS borrowers defaulted on their monthly interest installments, causing the special servicer for the CMBS debt to accelerate the loan and demand payment in full of all amounts under the CMBS loan (in excess of $3 billion). Shortly thereafter the special servicer commenced a foreclosure action against the real property, and on June 21, 2010, a judgment of foreclosure and sale was entered in favor of the CMBS lenders in an amount exceeding $3.6 billion.

On August 6, 2010, PSW NYC LLC (PSW) acquired the $300 million most senior mezzanine loans for $45 million and shortly thereafter commenced a UCC foreclosure on its equity collateral. The CMBS lenders advised PSW that it would need to cure the senior loan default by paying off the entire CMBS loan in accordance with Section 6(d) of the applicable intercreditor agreement before proceeding with its own equity foreclosure. PSW responded that this was "ludicrous" and informed the CMBS lenders that the intercreditor agreement did not require payment of the mortgage loan as a condition to foreclosure. The CMBS lenders brought an action in New York Supreme Court seeking a preliminary injunction preventing PSW from foreclosing without first paying off the CMBS loan, and from causing the CMBS borrowers to file for bankruptcy while the CMBS loan was outstanding, an action the CMBS lenders believed PSW would cause should it successfully foreclose on its equity collateral.

The decision focused on interpretation of Section 6(d) of the intercreditor agreement (and certain related provisions). Section 6(d) stated:

> *"To the extent that any Qualified Transferee acquires the Equity Collateral pledged to a Junior Lender pursuant to the Junior Loan Documents in accordance with the provisions and conditions of this Agreement...., such Qualified Transferee shall acquire the same subject to.... the Senior Loan and the terms, conditions and provisions of the Senior Loan Documents*.... for the balance of the term thereof, which shall not be accelerated by Senior Lender.... solely due to such acquisition and shall remain in full force and effect; *provided, however that* (A) such Qualified Transferee shall cause, within ten (10) days after the transfer....Borrower.... to reaffirm in writing, subject to such exculpatory provisions as shall be set forth in the Senior Loan Documents....all of the terms, conditions and provisions of the Senior Loan Documents....on Borrower's.... part to be performed and *(B) all defaults under.... the Senior Loan.... which remain uncured or unwaived as of the date of such acquisition have been cured by such Qualified Transferee* or in the case of defaults that can only be cured by the Junior Lender following its acquisition of the Equity Collateral, the same shall be cured by the Junior Lender prior to the expiration of the applicable Extended Non-Monetary Cure Period."

The Court found this language to clearly and unambiguously require PSW to cure all senior defaults. Since the default at issue was of a monetary nature — and not a default that could only be cured following PSW's acquisition of the equity collateral — PSW would be required to cure the default as of the date of its acquisition of its equity collateral. It was thus a precondition to PSW's acquisition of the equity collateral. The Court felt other sections of the intercreditor agreement supported this interpretation, including the provisions of another section of the intercreditor agreement entitled "Payment Subordination."

It is worth noting that the CMBS lenders also sought a declaration from the Court that Section 11(d) of the intercreditor agreement would prohibit PSW from orchestrating a CMBS borrower bankruptcy unless the senior loan is paid off in full. Section 11(d), entitled "Bankruptcy," provides in relevant part:

> *"For as long as the Senior Loan shall remain outstanding, none of the Junior Lenders shall solicit, direct or cause [CMBS] Borrower or any other entity which Controls Borrower . . . or any other Person to: (1) commence any Proceeding against Borrower* or any SPE Constituent Entity; (2) institute proceedings to have Borrower or any SPE Constituent Entity adjudicated as bankrupt or insolvent; (3) consent to, or acquiesce in, the institution of bankruptcy or insolvency proceedings against Borrower . . . or (9) *take any action in furtherance of any of the foregoing*. The terms and provisions of this Section 11(d) apply to each Junior Lender solely in its respective capacity as a Junior Lender. If any Junior Lender commences an Equity Collateral Enforcement Action against any Junior Borrower, and pursuant to such Equity Collateral Enforcement Action, such Junior Lender takes title to the Equity Collateral of such Junior Borrower, from and after the date title to such Equity Collateral is vested in such Junior Lender (as applicable), such Junior Lender shall be bound by the terms and provisions of the respective organizational documents of such Junior Borrower regarding bankruptcy and all matters requiring the vote of the independent directors/managers/members of such Junior Borrower."

The CMBS lenders believe that PSW intended to foreclose on its equity collateral, take control of the CMBS borrower, and put it into bankruptcy. PSW argued that this provision restricted its attempts to solicit, direct, or cause the CMBS borrowers to institute a bankruptcy proceeding only so long as it was a mezzanine lender. Once it completed its foreclosure of the equity collateral, PSW argued that it would no longer be subject to this provision. The Court dodged the issue by declaring the question moot, since the preliminary injunction was granted based on Section 6(d). It responded that since the CMBS loan would need to be repaid in full before PSW could foreclose on its equity collateral, there was no reason to decide

the bankruptcy issue. It therefore denied the injunction requested in respect of this declaration.

PSW has already filed an appeal seeking to overturn the preliminary injunction and is seeking to have the appellate court stay the CMBS mortgage foreclosure pending a final decision on the merits of its appeal. The stakes are quite high because a successful mortgage foreclosure of the CMBS loan would leave the mezzanine lenders with an equity pledge in entities devoid of any assets or value. On the flip side, should the mezzanine lenders be able to foreclose first, and be able to throw the CMBS borrower into bankruptcy, the mezzanine lenders could attempt to "cram down" and drag out the maturity of the CMBS loan, causing a significant loss to the CMBS certificate holders.

The Court's ruling will no doubt give rise to much concern on the part of the holders of mezzanine loans, as it now puts into question the ability of a mezzanine lender to foreclose following a default and acceleration of the senior loan without repaying the loan in full. While many may disagree, based on its careful reading of the relevant language in this particular intercreditor agreement, the Court seems to have come to the correct conclusion. In this case, the intercreditor agreement seems clearly to have provided that once the senior loan was accelerated; it had to be paid off before the mezzanine lender could foreclose. Other intercreditor agreements are less clear on this point, and might be read to require that the mezzanine lender keeping the senior lender's debt service current is only intended to prevent the senior lender from accelerating and commencing to foreclosure on its mortgage collateral, but not as an independent condition to the mezzanine lender foreclosing its collateral. This decision will very likely result in refinements to intercreditor agreements going forward to address this point as clearly as possible, and may cause some mezzanine lenders to negotiate the issue, as they will be even more uncomfortable with having to cure all senior loan defaults before being permitted to foreclose their own collateral.

We will keep you informed of how the appeals and any further actions by the mezzanine and/or CMBS lenders progress. Should you have any questions about the decision or Stuyvesant Town generally, please do not hesitate to contact any member of our Distressed Real Estate Group.

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