To be Argued by:
RONALD S. GREENBERG
(Time Requested: 30 Minutes)

APL-2019-00028
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Court of Appeals

STATE OF NEW YORK

SUTTON 58 ASSOCIATES LLC,

Plaintiff-Appellant,

— against —

PHILIP PILEVSKY, MICHAEL PILEVSKY, SETH PILEVSKY,
PRIME ALLIANCE GROUP, LTD., and SUTTON OPPORTUNITY LLC,

Defendants-Respondents.

BRIEF FOR PLAINTIFF-APPELLANT

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DISCLOSURE STATEMENT

Pursuant to Section 500.1(f) of the Rules of Practice of the Court of Appeals, plaintiff states that, with respect to parent entities, Sutton 58 Investor LLC and Gamma Lending S58 II LP are the sole members of plaintiff, that Sutton 58 Holding Company LLC is plaintiff's subsidiary, and that Sutton Development LLC is plaintiff's affiliate.

Dated: New York, New York
July 1, 2019

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Plaintiff-Appellant Sutton 58 Associates LLC appeals from the January 10, 2019 Decision and Order of the Appellate Division, First Department (the "Decision"): (i) reversing the March 8, 2018 Decision and Order of the Supreme Court, New York County (Kornreich, J.S.C.), which had denied Defendants-Respondents' motion for summary judgment; and (ii) dismissing the action on the ground that it is preempted by the Bankruptcy Code under the Supremacy Clause of the U.S. Constitution.

PRELIMINARY STATEMENT

In the Decision, the First Department found that purely state law claims asserted by one non-debtor against others for conduct occurring before and entirely outside of the debtors' bankruptcies were nevertheless preempted by the Bankruptcy Code. This remarkable outcome is not supported by any prior preemption jurisprudence. On the contrary, the Decision conflicts with a number of cases, including *In re Extended Stay Inc.*, 435 B.R. 139 (S.D.N.Y 2010) ("*Extended Stay*"), the only other preemption case decided on analogous facts. There, the United States District Court for the Southern District of New York held that claims asserted by a lender against a non-debtor for tortious interference with a debtor's loan covenants were *not* preempted by the federal Bankruptcy Code. And with good reason. There plainly was no warrant – or precedent – for the First Department's holding that the Bankruptcy Code preempts the identical claims asserted here, which arose prior to,

and were unrelated to anything occurring in, the bankruptcies, particularly where there is no federal forum for those claims.

To be sure, the three sentences of reasoning in the Decision do not meaningfully address either type of preemption urged by defendants. The Decision does not even attempt to identify any "conflict" between plaintiff's claims and the Bankruptcy Code (which goes unmentioned) or any Congressional intent to occupy the "field" covered by New York's tortious interference jurisprudence. Rather it merely cites two cases that are entirely distinguishable because they preempted claims predicated on alleged bad-faith bankruptcy filings – a circumstance expressly covered by the Bankruptcy Code.

The Decision has not been well received. Indeed, as one commentator bluntly noted, it is both "wrongly decided" and "bad precedent."[1] And several others have observed that, if left standing, the Decision is likely to hamper real estate development in New York. As put by Supreme Court, which denied preemption but was reversed, the result reached in the Decision will "upend the way contracts are written here in New York City and upend the whole . . . land development industry."

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[1] *See* Allie Strauss and Adoral Nworah, *"Nobody Fell Off the Turnip Truck Yesterday": What's at Stake for Commercial Real Estate Lenders in Sutton 58?*, LexBlog (May 31, 2019), https://www.lexblog.com/2019/05/31/nobody-fell-off-the-turnip-truck-yesterday-whats-at-stake-for-commercial-real-estate-lenders-in-sutton-58/ (the "LexBlog Article").

(R. 15).[2] This possibility has not been lost on the lending community. As reported shortly after the Decision was issued: "One active New York construction lender . . . said the [Decision] could potentially create 'massive problems for commercial real estate lending.' "[3] This is because the loan covenants in question required the debtor-borrowers to remain special-purpose entities, whose sole permitted purpose was to develop a specific real estate project. And the principal reason for a lender like plaintiff requiring its borrowers to remain as special-purpose entities is that, in the event of a default, a subsequent bankruptcy would be likely to end quickly, permitting such lenders to secure their collateral without protracted bankruptcy proceedings.

Left unchecked, the Decision instead would permit unscrupulous vulture capitalists to tortiously interfere with distressed borrowers' loan covenants with impunity, rendering special-purpose entity structures meaningless to lenders. Given both its lack of legal support, as well as the uncertainty and alarm it has caused in both the lending and legal communities, the flimsily reasoned Decision should be reversed.

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[2] Citations to the Record on Appeal are denominated as "(R. ___)."

[3] *See* Mack Burke and Cathy Cunningham, *Latest Sutton 58 Court Decision Could 'Upend' Construction Financing Deals: Ruling in Gamma Real Estate's Sutton 58 project OKs the circumvention of special-purpose entities and could make construction financing more expensive*, Commercial Observer (Jan. 11, 2019), https://commercialobserver.com/2019/01/latest-sutton-58-court-decision-could-upend-construction-financing-deals/.

QUESTION PRESENTED FOR REVIEW

Does the federal Bankruptcy Code preempt a non-debtor lender's state law claims against other non-debtors for tortiously causing non-party debtors to breach their loan covenants where, as the trial court found, those claims "stem from breaches of [contractual] clauses, not from the bankruptcy [proceedings]" (R. 20), where there is no federal forum for the claims, and where such a result would undermine special-purpose entity provisions in sophisticated loan agreements, thereby unnecessarily inhibiting construction financing?

STATEMENT OF JURISDICTION

Because the Decision finally determined the action through its construction of the Supremacy Clause of Article VI of the U.S. Constitution, on February 6, 2019, plaintiff filed its Notice of Appeal "as of right" pursuant to CPLR 5601(b)(1). By letter dated February 15, 2019, John P. Asiello, Chief Clerk and Legal Counsel to the Court, informed the parties that the Court, on its own motion, would consider its subject matter jurisdiction, and invited the parties to submit written comments. After the parties did so, by letter dated May 2, 2019, Mr. Asiello informed the parties that: "The Court ha[d] terminated its jurisdictional inquiry and the appeal now will proceed in the normal course of briefing and argument."

This question was presented below and is therefore preserved. *See* (R. 16, 18-19, 23, 30); *see also* Plaintiff's Appellate Division Brief at 5, 24-33.

STATEMENT OF FACTS

A. The Project and the Loan Agreements

On June 19, 2015, plaintiff loaned BH Sutton Mezz LLC ("Mezz Borrower"), and its wholly owned subsidiary, Sutton 58 Owner LLC ("Mortgage Borrower"; together, "Borrowers"), the aggregate principal amount of $147,250,000 to develop a tower at Sutton Place and 58th Street in Manhattan (the "Project"). BH Sutton Owner LLC ("Sutton Parent") owned 100% of the membership interests in Mezz Borrower. (R. 798 at ¶ 21). These loans were documented in a routine mezzanine loan structure, consisting of, among other things: (1) a Mezzanine Loan Agreement with Mezz Borrower in the amount of $20,000,000; (2) an Acquisition Loan Agreement with Mortgage Borrower in the amount of $125,850,000; and (3) a Building Loan Agreement with Mortgage Borrower in the amount of $1,400,000, all dated as of June 19, 2015 (collectively, the "Loan Agreements"). (R. 818-1014).

Article 4 of the Loan Agreements contains Borrowers' loan covenants, a host of which are central to plaintiff's tortious interference claims. Together, these standard-issue loan covenants protected plaintiff by making clear that Borrowers' only permitted purpose was to develop the Project. Specifically, these covenants tightly restricted Borrowers' ability to take on any other loans (R. 840, 902, 962), required Borrowers to pay their debts out of their own assets (R. 839, 875, 901, 934, 961, 1013), and prohibited Borrowers from conducting any business outside of the

Project (R. 901-02, 933, 961-62, 1012), from owning any other assets (R. 840, 901, 961), and from permitting any other entity to take an ownership interest in them. (R. 828, 841, 890, 902, 951, 962). These provisions expressly required Borrowers to remain as special-purpose entities – or, as they were defined in the Loan Agreements, "Special Purpose Bankruptcy Remote Entit[ies]." (R. 839, 874, 901, 933, 961, 1012). While these common provisions do not, of course, prohibit a bankruptcy filing – which would be void as against public policy – they are designed to ensure a speedy bankruptcy, if one is filed, so that plaintiff would not be subject to market and other risks attendant to protracted proceedings while asserting control over its collateral in the event of a loan default.[4]

Mezz Borrower and plaintiff also signed a Pledge and Security Agreement (the "Pledge Agreement") in which Mezz Borrower pledged, as collateral for the Mezzanine Loan, its 100% membership interest in Mortgage Borrower to plaintiff. (R. 1015-25). Mezz Borrower and plaintiff agreed that, upon a maturity default, plaintiff could sell that 100% membership interest at a UCC foreclosure sale. (R.

[4] *See, e.g.,* David Djaha, Keith Wofford and Chrystal Laroche, *Protect Yourself From Bad Boys*, N.Y.L.J., p. 10 (col. 1), Aug. 13, 2012 ("Due to the requirements of capital markets, many commercial real estate loan transactions require that the borrower is a single purpose entity (SPE) and holds the loan collateral as its sole asset(s). Lenders and investors favor this model because it isolates the SPE's assets in the event that the borrower's corporate affiliates file bankruptcy, hopefully preventing the lender's collateral from becoming part of a larger debtor's estate, minimizing the consolidation risk.").

801). The Pledge Agreement thus provided additional crucial protection to plaintiff; in the event of a default, plaintiff could secure the collateral for its nearly $150 million in loans quickly, pursuant to a UCC foreclosure sale, and without lengthy foreclosure litigation.

B. The Maturity Defaults and the Preliminary Injunction Proceeding

The loans matured on January 19, 2016. When Borrowers did not pay, plaintiff issued notices of default and sought to conduct a secured party sale (the "UCC Sale") of Mezz Borrower's membership interest in Mortgage Borrower pursuant to the Pledge Agreement and the Uniform Commercial Code. (R. 1026-50). On February 17, 2016, Borrowers filed a motion for a preliminary injunction to prevent the UCC Sale. On February 23, 2016, Justice O. Peter Sherwood denied Borrowers' motion for a preliminary injunction, holding that Borrowers were unlikely to succeed on the merits, that they would not be irreparably harmed by the UCC Sale, and that the equities favored allowing plaintiff to enforce the Pledge Agreement. (R. 1051-53). Justice Sherwood ordered that the UCC Sale could proceed on February 29, 2016. *Id.* The day before Justice Sherwood's ruling, Cushman & Wakefield had appraised the Project's development site at 428-432 East 58th Street (the "Property") at an "as is" value of $180-85 million. (R. 1055-56).

C. Defendants' Tortious Interference with the Loan Agreements

Immediately following the denial of Borrowers' motion for a preliminary injunction, defendants began conspiring with one of Borrowers' principals, Joseph Beninati, to prevent the UCC Sale by repeatedly and deliberately interfering with plaintiff's rights under the Loan Agreements. The conspiracy began on or about February 24, 2016, when Mr. Beninati executed an engagement letter with Robyn Tuerk to provide legal services to him and to Mortgage Borrower in connection with the Property. (R. 1057-58). Ms. Tuerk is the Corporate General Counsel of Philips International, a company founded and led by defendant Philip Pilevsky. (R. 1080-81, 1350-51). However, Ms. Tuerk did not sign the engagement letter as General Counsel of Philips International. Rather, she signed in her own name, on her own letterhead. (R. 1057-58). Aside from the engagement letter, defendants have not provided any substantive communications between Ms. Tuerk and Mr. Beninati in discovery.

Two days after Mr. Beninati "retained" Ms. Tuerk, on February 26, 2016, in direct violation of its loan covenants, Mezz Borrower borrowed $50,000 (the "Pilevsky Loan") from defendant Prime Alliance Group Ltd. ("Prime Alliance") – whose President and sole owner is Philip Pilevsky – and used the loan proceeds to pay a retainer to Mezz Borrower's bankruptcy counsel, LaMonica Herbst & Maniscalco, LLP ("LH&M"). (R. 1078 at ¶ 3; R. 1176 at ¶ 3). That same day, the

last business day before the scheduled UCC Sale, Mezz Borrower filed a voluntary petition for bankruptcy under Chapter 11 of the Bankruptcy Code (the "Mezz Borrower Bankruptcy") with the United States Bankruptcy Court for the Southern District of New York (the "Bankruptcy Court"). (R. 1071-74). According to an affidavit filed by Mezz Borrower's president, the purpose of the bankruptcy filing was to prevent the UCC Sale planned by plaintiff and to preserve Mezz Borrower's equity in the Property notwithstanding its default – *i.e.*, to frustrate plaintiff's contractual rights. (R. 1077 at ¶ 18).

In addition, according to an affidavit submitted by Philip Pilevsky, Prime Alliance made the $50,000 loan to Mezz Borrower at the request of his son, defendant Michael Pilevsky, one of the principals of defendant Sutton Opportunity LLC ("Sutton Opportunity"). (R. 1176-77 at ¶¶ 3, 5). (The other principal is Philip Pilevsky's other son, defendant Seth Pilevsky.) (R. 1180 at ¶ 7). There is no record that Prime Alliance received any consideration from defendant Sutton Opportunity or Michael Pilevsky for making a loan at their behest.

On February 25, 2016, Sutton Opportunity was incorporated in Delaware. (R. 1341). Then, beginning on February 26, 2016, three one-bedroom cooperative apartments located in Lynbrook, New York (the "Pilevsky Apartments") were

transferred, ultimately, to Mortgage Borrower (the "Pilevsky Apartments Transfer"), in violation of its loan covenants.[5]

D. Defendants' Tortious Interference Successfully Delays Plaintiff's Exercise of Its Contractual Rights

On March 10, 2016, plaintiff moved to dismiss the Mezz Borrower Bankruptcy or, in the alternative, to lift the automatic stay in order to pursue the UCC Sale. Plaintiff's primary argument was that Mezz Borrower did not have any bona fide creditors – because Mezz Borrower was just a holding company, not an operating business – and that the bankruptcy was merely a two-party dispute that Mezz Borrower had moved from state court to the Bankruptcy Court to take advantage of the automatic stay. (R. 1151-52, 1155, 1163-67).

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[5] Further details of defendants' tortious interference scheme are no less disturbing. Prior to February 26, 2016, the Pilevsky Apartments were owned by Lynbrook Apartment Associates LLC ("Lynbrook Associates"), whose general partner is affiliated with Philip Pilevsky's entity, Philips International. (R. 1092 at ¶ 1.1; R. 1140, 1332-33). Then, on or about February 26, 2016, Lynbrook Associates transferred the apartments to Sutton Opportunity. (R. 1059). Thereafter, in direct violation of Mortgage Borrower's loan covenants, Sutton Opportunity obtained a 49% ownership stake in Sutton Parent – the ultimate corporate owner of a Project then valued at $180-85 million – in exchange for contributing to Mortgage Borrower (not Sutton Parent, which received nothing) the Pilevsky Apartments and $200,000 in cash, including $150,000 to pay LH&M a retainer to file a bankruptcy petition for Mortgage Borrower. (R. 1189-90, 1198-1200). For her part, Ms. Tuerk was actively involved in executing the Pilevsky Apartments Transfer while simultaneously wearing the hats of counsel to Philips International, Lynbrook Associates, Mortgage Borrower, and Mr. Beninati. *See, e.g.,* (R. 1080) (directing drafting of contract documents and attempting to expedite the closing); (R. 1082) (describing the "intent" of the transaction and her clients' "flexib[ility]" on contractual language, so long as Mortgage Borrower held the "unsold shares").

On April 6, 2016, the day before the motion was to be heard, Mortgage Borrower filed a voluntary petition for bankruptcy (the "Mortgage Borrower Bankruptcy"; together with the Mezz Borrower Bankruptcy, the "Bankruptcy Cases"). (R. 1126-29). Because of defendants' tortious interference with Mortgage Borrower's loan covenants – namely, its improper receipt of the Pilevsky Apartments – Mr. Beninati was able to swear in the bankruptcy petition that Mortgage Borrower was not a "Single Asset Real Estate" debtor under the Bankruptcy Code (R. 1127), making it dramatically more difficult for plaintiff to obtain relief from the automatic stay. *See* 11 U.S.C. § 362(d)(3). In a motion Mortgage Borrower filed along with the petition, it represented that it owned assets in addition to the Property – *i.e.*, the Pilevsky Apartments. (R. 1143).

The filing of the Mortgage Borrower Bankruptcy was also timed to disrupt plaintiff's motion to dismiss Mezz Borrower's bankruptcy and delay the disposition of the Bankruptcy Cases. In particular, because Mortgage Borrower actually did have creditors (unlike Mezz Borrower), Mortgage Borrower's filing undercut plaintiff's argument that the bankruptcy should be dismissed because it was merely a two-party dispute. As a result, at the April 7 hearing, the Bankruptcy Court stated it would be "premature" at that time for the court to "buy in" to any "narrative about what's going on underlying the project and who did what to whom and how it should be characterized." (R. 1345-46).

Given the Bankruptcy Court's view, plaintiff withdrew its motion to dismiss.[6] Thus, enabled by defendants' tortious interference, plaintiff could not obtain an expeditious dismissal of the Bankruptcy Cases. Instead, its collateral remained out of reach for the balance of 2016, while the Bankruptcy Cases ran their course, leading inevitably to a Plan of Liquidation. Pursuant to it, on December 13, 2016, the Property was sold at an auction sale following competitive bidding. Plaintiff's winning credit bid was $86 million, *some $100 million below the appraised value of the Property at the time the UCC Sale was originally scheduled in February 2016*. (R. 1348 at ¶ 5).

The Pilevsky Loan and the Pilevsky Apartments Transfer (collectively, the "Pilevsky Scheme") were intended to, and did, cause Borrowers to breach the Loan

[6] The Decision appeared to attach undue significance to plaintiff's withdrawal of the motion to dismiss (R. 1568), which was necessitated by defendants' tortious interference. It is unclear why the First Department may have believed the withdrawal of that motion *against debtor-Borrowers* somehow implies that there might be a federal forum for plaintiff's tortious interference claims *against non-debtor-defendants* or otherwise supports the notion that those state law claims are preempted by the federal Bankruptcy Code. Predictably, in its brief opposing leave to appeal, defendants made the same error: wrongly arguing that the potential availability of a motion to dismiss the Bankruptcy Cases as filed in bad faith – which, ironically, defendants' tortious interference thwarted – meant that there was a "remedy" for such tortious interference against defendants in the Bankruptcy Court. That is simply mistaken. As demonstrated below, the Bankruptcy Court would not have had jurisdiction over state law claims asserted by one non-debtor against another that could have no impact on the assets or administration of the debtor's estate. *See infra* at 31-32, and cases cited therein.

Agreements and prevented plaintiff from expeditiously exercising its contractual remedies for Borrowers' maturity defaults. This contractual right to a quick sale was important to minimize plaintiff's exposure to rezoning efforts and the volatile New York real estate market.[7] The Pilevsky Scheme has required plaintiff to incur substantial attorneys' fees and costs, and the Project – rather than being put up for auction in February 2016 – was left undeveloped and at a standstill in a falling real estate market. Further undermining the value of the Project, the delay allowed a community group and local politicians time to zealously lobby to rezone the area where the Project is located and to impede its construction. These efforts achieved their objective. On November 30, 2017, the City amended the zoning applicable to the Property, and, on the same day, the Department of Buildings issued a stop-work order. As a result, work on the Project was indefinitely suspended. (R. 1340).

E. Procedural History and the Lower Court Decisions

On September 16, 2016, plaintiff commenced this action alleging that defendants tortiously interfered with the Loan Agreements. On November 21, 2016, defendants filed a motion to dismiss, claiming that plaintiff's damages were

[7] Since January 2016, numerous articles have commented on the declining prices and troubles in the market for luxury high-rise apartments in Manhattan and developments like the Project. *See, e.g.,* (R. 1334) ("These projects are in limbo just as the ultraluxury market weakens and there are warnings of a coming downturn across the board."); (R. 1206) ("New York City's ultraluxury real estate frenzy . . . has finally come to an end"); (R. 1148) (noting "slowing luxury market").

unrecoverable. After oral argument, on April 25, 2017, Commercial Division Justice Shirley Werner Kornreich denied defendants' motion to dismiss from the Bench.

With discovery underway, but far from completed, on October 23, 2017, defendants filed a second dispositive motion, this time seeking summary judgment, and asserting that plaintiff's claims should be dismissed: (i) under the *Noerr-Pennington* doctrine; (ii) as preempted by the Bankruptcy Code; (iii) because they are based on an unenforceable restriction on filing for bankruptcy; and (iv) as against the individual defendants, because there purportedly was no basis to pierce the corporate veil. On March 6, 2018, after full briefing and argument, the trial court denied defendants' motion from the Bench. (R. 6).

Concerning preemption, Justice Kornreich repeatedly stressed that Borrowers' contractual breaches were distinct from anything occurring in their bankruptcies. *See, e.g.,* (R. 18) ("I don't have to rule about the bankruptcy. This case does not involve the bankruptcy itself. It involves separate contractual agreements."); (R. 20) (plaintiff's claims "stem from breaches of these clauses, not from the bankruptcy"); (R. 28) ("We're not dealing with the bankruptcy here. . . . We're dealing with a separate contract. Separate breaches. Not the bankruptcy.").

In light of the foregoing, Justice Kornreich held that "[t]here's no federal preemption here." (R. 18).[8]

The trial court also repeatedly stated that adopting defendants' arguments would "upend the way contracts are written here in New York City and upend the whole . . . land development industry." (R. 15); *see also* (R. 21) (defendants' position "would undermine the way business is dealt with in New York City when it comes to lenders and developers" and "upend[] all of these contracts and the way business has been done for years"). Justice Kornreich further observed that the Loan Agreements were "similar to loan papers I see all the time," in which a lender provides a loan to "an entity which is really a single purpose entity, and the only thing the entity has is the land and is going to develop this land." (R. 10). In denying the motion, the trial court further recognized that it was "important" to plaintiff that Mortgage Borrower remain a special-purpose entity that "would not enter into any other business" aside from the Project and that Mezz Borrower was "organized solely for the purpose of acting as member of the limited liability company that owns the property." (R. 11).

[8] The trial court also rejected all of defendants' other arguments, but since the Appellate Division did not reach them, the parties have agreed not to address those arguments on this appeal. Rather, by this footnote, the parties jointly request that, in the event this Court reverses on the preemption issue, it remand the case to the Appellate Division to address the remaining issues.

Defendants appealed to the Appellate Division, First Department, and on January 10, 2019, that court reversed, finding plaintiffs' claims were preempted by "federal law," presumably the Bankruptcy Code, though it did not expressly say so. (R. 1566). And, as discussed further below, the two cases it cited are both readily distinguishable as, unlike here, they both preempted claims based on purported misconduct occurring within bankruptcy proceedings for which the Bankruptcy Code provides remedies. The exceedingly brief Decision did not at all address: (a) *Extended Stay,* the only case ever decided on analogous facts, and which reached the opposite result; (b) the complete absence of a federal forum for plaintiffs' claims that it nevertheless found to be preempted by federal law; or (c) its ramifications for the real estate development industry in New York – although all three topics were featured prominently in plaintiff's brief.

ARGUMENT

THE BANKRUPTCY CODE DOES NOT PREEMPT PLAINTIFF'S CLAIMS

A. The Governing Principles Make Clear that Plaintiff's Claims Are Not Preempted

No theory of preemption bars plaintiff's claims. While the Supremacy Clause gives Congress the power to preempt state law, *Arizona v. United States*, 567 U.S. 387, 399 (2012), courts "start with the assumption that the historic police powers of the States were not to be superseded by [a] Federal Act unless that was the clear and manifest purpose of Congress." *Rice v. Santa Fe Elevator Corp.*, 331 U.S. 218, 230

(1947). Below, defendants did not claim that "express" preemption applies – *i.e.*, that the "manifest purpose" of the Bankruptcy Code is to preempt plaintiff's state law claims. They only argued for "implied" preemption, of which there are two types: (i) "conflict preemption," which arises "by implication because of a conflict with a congressional enactment"; and (ii) "field preemption," where "the depth and breadth of a congressional scheme [] occupies the legislative field." *Lorillard Tobacco Co. v. Reilly*, 533 U.S. 525, 541 (2001) (citations omitted). "It is firmly settled that a party contending that a federal law preempts state law has the burden of establishing preemption." *Stratton v. Wallace*, 11-CV-74-A, 2016 WL 3552147, at *4 (W.D.N.Y. Apr. 5, 2016).

Even a cursory examination of these two types of preemption makes clear that defendants cannot carry this burden because neither the Bankruptcy Code nor anything involved in the Bankruptcy Cases could have any bearing on plaintiff's state law claims for tortious interference with the Loan Agreements. For example, there are two sub-categories of conflict preemption – "impossibility" and "obstacle" (*see generally Marentette v. Abbott Laboratories, Inc.*, 886 F.3d 112, 117 (2d Cir. 2018)) – and both are inapplicable here. With respect to the former, state law is "pre-empted where it is *impossible* for a private party to comply with both state and federal requirements." *Mut. Pharm. Co. v. Bartlett*, 570 U.S. 472, 480 (2013) (emphasis added) (citation and internal quotation marks omitted) (finding state law

claims preempted where it was impossible to comply with state-law duty to strengthen drug label warnings and federal-law duty not to alter the label). There certainly is nothing in the New York common law of tortious interference that somehow made it "impossible" for defendants to comply with the Bankruptcy Code. Nor is there anything in the Code that compelled their tortious interference. This sub-category of preemption plainly does not apply to this dispute.

"Obstacle" conflict preemption is also wholly inapplicable here. As described by the Second Circuit:

> The obstacle branch of conflict preemption . . . precludes state law that poses an actual conflict with the overriding federal purpose and objective. . . . What constitutes a sufficient obstacle is a matter of judgment, to be informed by examining the federal statute as a whole and identifying its purpose and intended effects. . . . As with the impossibility branch of conflict preemption, the purpose of Congress is the ultimate touchstone, and *the conflict between state law and federal policy must be a sharp one. . . . The burden of establishing obstacle preemption, like that of impossibility preemption, is heavy. . . . Indeed, federal law does not preempt state law under obstacle preemption analysis unless the repugnance or conflict is so direct and positive that the two acts cannot be reconciled or consistently stand together.*

Figueroa v. Foster, 864 F.3d 222, 234-35 (2d Cir. 2017) (emphasis added) (citations and internal quotation marks omitted).

Again, considering situations in which obstacle conflict preemption is actually applied sheds light on why that should not be the case here. *See, e.g., Geier v. Am.*

Honda Motor Co., 529 U.S. 861, 881 (2000) (tort claim against manufacturer for injury sustained in a car without an airbag preempted by federal regulation that only required "10% of a manufacturer's nationwide fleet be equipped with any passive restraint device at all"; finding such claim "would have stood as an obstacle to the gradual passive restraint phase-in that the federal regulation deliberately imposed"). Without question, neither the First Department nor defendants has identified any "sharp conflict" between New York's tortious interference common law and the Bankruptcy Code, let alone one in which "the repugnance or conflict is so direct and positive that the two acts cannot be reconciled or consistently stand together." *Figueroa*, 864 F.3d at 134 (citations and internal quotation marks omitted). On the contrary, below, defendants repeatedly asserted that Borrowers' Bankruptcy Cases were completed successfully. Thus, by their own logic, plaintiff's lawsuit could not have been an "obstacle" to any federal policy, and certainly poses no obstacle today, several years after the Plan of Liquidation in the Bankruptcy Cases was consummated. (R. 599).

As with conflict preemption, the principles governing field preemption negates its use in this case:

> [I]n the absence of explicit statutory language, state law is pre-empted where it regulates conduct in a field that Congress intended the Federal Government to occupy exclusively. Such an intent may be inferred from a scheme of federal regulation . . . so pervasive as to make reasonable the inference that Congress left no room for the

> States to supplement it, or where an Act of Congress touch[es] a field in which the federal interest is so dominant that the federal system will be assumed to preclude enforcement of state laws on the same subject. Although this Court has not hesitated to draw an inference of field pre-emption where it is supported by the federal statutory and regulatory schemes, it has emphasized: *"Where . . . the field which Congress is said to have pre-empted" includes areas that have "been traditionally occupied by the States," congressional intent to supersede state laws must be " 'clear and manifest.' " Jones v. Rath Packing Co.,* 430 U.S. 519, 525 (1977), quoting *Rice v. Santa Fe Elevator Corp.,* 331 U.S. at 230.

English v. Gen. Elec. Co., 496 U.S. 72, 79 (1990) (emphasis added) (other citations and internal quotation marks omitted).

The cases applying field preemption further demonstrate the doctrine's inapplicability here. *See, e.g.*, *United States v. Locke*, 529 U.S. 89, 108 (2000) (Washington state law permitting state agency to regulate oil tankers in Washington ports preempted by comprehensive federal regulatory scheme governing oil tankers where the "state laws now in question bear upon national and international maritime commerce"); *Hines v. Davidowitz*, 312 U.S. 52, 62, 74 (1941) (seminal field preemption case striking down Pennsylvania foreign citizens registration act, which overlapped with a federal foreign citizens registration statutory and regulatory scheme; noting "the supremacy of the national power . . . over immigration, naturalization and deportation" and that Congress "has provided a standard for alien registration in a single integrated and all-embracing system"). There has been no

suggestion, either by defendants or in the Decision, that there is “clear and manifest” “congressional intent to supersede” plaintiff’s state law tortious interference claims, which concern only non-debtors and are entirely unrelated to the Bankruptcy Code. *English*, 496 U.S. at 79 (citations and internal quotation marks omitted).

In sum, there is no underlying support in any of the preemption jurisprudence for the radical result reached by the First Department in the Decision.

B. The Relevant Authorities <u>Provide No Basis for Preemption</u>

In analyzing the federal preemption doctrine, courts distinguish between claims based on filings or conduct within bankruptcy proceedings and state law claims concerning contracts that are to be performed outside of bankruptcy proceedings, such as the ones at issue here. *See, e.g., Extended Stay*, 435 B.R. at 149 (denying preemption because plaintiff sought “recovery pursuant to contracts,” not to “punish[] the exercise of rights under the Bankruptcy Code, nor [to] question the legal validity or propriety of the Debtors’ filings”); *see also Long v. Bank of Am., N.A.*, 17 CV 2756, 2018 WL 5830794, at *2 (N.D. Ill. Nov. 7, 2018) (denying preemption of claim for breach of a settlement agreement that resolved a sanctions motion filed in a bankruptcy proceeding because “the Bankruptcy Code does not preempt a state law claim where it exists absent the Code, and can be determined without doing violence to the Code’s purpose of adjudicating all competing claims to a debtor’s property in one forum and one proceeding”). Given the governing

preemption principles discussed above, this conclusion is hardly surprising. Nothing about a non-debtor pursuing state law claims against another non-debtor for inducing a breach of contract prior to a bankruptcy makes it "impossible" to comply with the Bankruptcy Code or creates an "obstacle" to a debtor pursuing its bankruptcy, nor does the Code occupy the field of tort claims among non-debtors for pre-bankruptcy conduct.

Indeed, tort claims – including for tortious interference with contract, and even for " '*inducing*' . . . *[d]ebtors into bankruptcy*" – should not be preempted where, as here, the claims are based on misconduct by non-debtors outside of the bankruptcy. *Extended Stay*, 435 B.R. at 151 (emphasis added). This is especially so here, where the claims "concern conduct that occurred *prior to* bankruptcy." *Davis v. Yageo Corp.*, 481 F.3d 661, 678 (9th Cir. 2007) (emphasis in original); *see also Extended Stay*, 435 B.R. at 152 (denying preemption where claim that actions taken "prior to the bankruptcy filings violated contractual or common-law duties . . . does nothing to demonstrate a connection with the bankruptcy process").

In denying preemption of tort claims, *Davis* as well as *F.D.I.C. v Barton*, No. Civ. A. 94-3294, 1998 WL 169696 (E.D. La. Apr. 8, 1998), are both particularly noteworthy. In both cases, the breach of fiduciary duty claims asserted against directors of the debtor (or its parent entity) that were permitted to proceed were based on the directors' "*decision to commence bankruptcy*." *Davis*, 481 F.3d at 670

(emphasis added); *see also Barton*, at *2. In addition to *Davis* noting that the subject claims arose prior to the bankruptcy, the cases denied preemption for several other reasons that are equally applicable here: namely, the disputes were between non-debtors and implicated only state law in an area not covered by the Bankruptcy Code. *See Davis*, F.3d at 678-79; *Barton*, at *4.

Moreover, both cases distinguished two of the principal cases relied on below by plaintiffs on these very grounds. *See Davis*, 481 F.3d at 678-80; *Barton*, at *3-4.[9] While the Decision simply ignored *Barton*, it inexplicably said that "unlike *Davis* . . . plaintiff's damages arise only because of the bankruptcy filings." (R. 1569). But this is wrong at two levels. First, as we stated repeatedly, plaintiff's claims for damages are *not* based on any "bankruptcy filings," but arose out of defendants' pre-bankruptcy misconduct. Second, this attempted "distinction" of *Davis* is no distinction at all, as the tort claims in that case (and in *Barton*) were based on the directors' very decision to file the debtor for bankruptcy. Surely, if tort claims asserted against a debtor's own board members that are based on their supposed wrongful decision to file an actual debtor into bankruptcy are not preempted, then, *a fortiori*, claims against these defendants, who are strangers to the debtor but claim they are protected because they "facilitated" a bankruptcy, are not either.

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[9] Distinguishing *MSR Exploration, Ltd. v. Meridian Oil, Inc.*, 74 F.3d 910 (9th Cir. 1996) and *Gonzales v. Parks*, 830 F.2d 1033 (9th Cir. 1987), discussed further *infra* at 27-28, 30.

The Decision also conflicts with *Dougherty v. Wells Fargo Home Loans, Inc.*, 425 F. Supp. 2d 599 (E.D. Pa. 2006). There, plaintiff-mortgagor brought breach of contract and statutory unfair trade practices claims based on defendant-mortgagee's charging post-petition attorneys' fees incurred in plaintiff's bankruptcy without seeking bankruptcy court approval. In denying defendants' motion to dismiss on preemption grounds, the court held:

> Plaintiff's state law claims do not presuppose violations of the Bankruptcy Code. Consequently, there is no risk of conflict between enforcement of the state laws and enforcement of the federal bankruptcy laws. *Indeed, merely because a Plaintiff brings a state law claim in the context of a bankruptcy matter does not justify preemption of those claims, particularly where the underlying facts of the state law claim are not based on a violation of the Code.*

Id. at 609 (emphasis added). This is yet another case that demonstrates plaintiff's claims here – on state law causes of action that allege no violation of the Bankruptcy Code – do not in any way "conflict" with federal law and are not preempted.

Finally, as noted above, *Extended Stay* is the only other reported case that has addressed the present issue on analogous facts. There, a mezzanine lender (Line Trust) brought state court tortious interference and related claims against non-debtor defendants arising out of breaches of Line Trust's loan covenants with its borrower (Extended Stay), which had filed for bankruptcy. Defendants removed the case as "arising under" the Bankruptcy Code and claimed that the state law claims were

preempted. Judge Swain denied the appeal of Line Trust's successful motion to remand in language that largely could have been written for this case:

> *The tort-based claims in the Line Trust action arise from the bankruptcy-remote aspects of the Extended Stay financing arrangements. . . .* Line Trust . . . assert[s] that [defendants] are liable for damages on various tortious interference, fiduciary and collusion theories for . . . *procuring the breach of covenants in financing documents. . . .* There is no claim that the filing of the bankruptcies was wrongful under the Bankruptcy Code. *Rather, the gravamen of the Line Trust Plaintiffs' tort claims is the alleged violation of contractual and state law duties to continue or consummate arrangements outside of bankruptcy under which Line Trust and its creditor peers could have received more favorable treatment than they appear likely to see in bankruptcy.*

Id. at 151 (emphasis added).

The court went on to reject "[a]ppellants' preemption-based 'arising under' arguments" and, in doing so, applied the same reasoning set forth earlier in the decision with respect to a different state court plaintiff's claim – on a guaranty of the underlying debt – that was also removed and then remanded. *Id.* Specifically, Judge Swain found that, because the claims at issue were "asserted in state law terms only," the Line Trust appellants could not establish that those "claims . . . are preempted by or otherwise arise under the Bankruptcy Code." *Id.* at 149. Notably, those appellants unsuccessfully attempted to rely on *Astor Holdings, Inc. v. Roski*, 325 F. Supp. 2d 251 (S.D.N.Y. 2003), discussed further below, which is the main case relied upon both by the First Department and by defendants below. (R. 1568).

Extended Stay is the only previously reported case ever to consider (and reject) preemption of state law claims for tortious interference with loan covenants, which caused a lender damages due to disadvantageous treatment in its borrower's bankruptcy. Its relevance here cannot be overstated. As observed by one commentator:

> The First Department's decision is in apparent tension with the Southern District's decision in *In re Extended Stay Inc*. . . . It is difficult to reconcile the two decisions, and the First Department's decision did not address *In re Extended Stay*.

Janice MacAvoy, Matthew Parrott and Justin Santolli, *Why NY's Sutton 58 Decision Won't Rattle Real Estate Finance*, Law360 (Feb. 7, 2019), https://www.law360.com/articles/1126535/why-ny-s-sutton-58-decision-won-t-rattle-real-estate-finance (the "Law360 Article").

Although the Decision remarkably ignored *Extended* Stay, its reasoning provides ample grounds for reversal here.[10]

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[10] In opposing plaintiff's motion for leave to appeal, defendants strained to distinguish *Extended Stay* as applying only to "complete preemption," which they acknowledge does not apply here. The effort does them no good. In finding the preemption arguments made in *Extended Stay* were "insufficient," Judge Swain specifically distinguished "complete preemption" cases such as *MSR Exploration, Ltd. v. Meridian Oil, Inc.*, 74 F.3d 910 (9th Cir. 1996) and *Astor Holdings, Inc. v. Roski*, 325 F.Supp. 2d, 251 (S.D.N.Y. 2003) (discussed further *infra* at 27-28, 30), the very cases upon which defendants purport to rely, but now must necessarily concede are inapposite based on their own argument. Moreover, while defendants' claimed that *Extended Stay* left open the possibility that the Line Trust and other

(footnote continued. . .)

C. Defendants' Cases Are Inapposite

Below, defendants relied heavily on *Astor* and four other inapposite cases, which – unlike this case, as well as *Extended Stay, Davis* and *Barton* – preempted claims that were based solely on conduct occurring within bankruptcy proceedings. For example, *Astor* merely held that certain claims were preempted insofar as they "requir[ed] a finding that [the debtor] filed for bankruptcy or filed certain papers in the bankruptcy proceedings in bad faith or for an improper purpose." *Astor,* 325 F. Supp. 2d at 263.

Astor relied heavily on *Choy v. Redland Ins. Co.*, 103 Cal. App. 4th 789 (2002), where the outcome "depend[ed] upon [plaintiff's] right to litigate, in state court, the question of [defendant's] alleged 'bad faith' bankruptcy petition." *Id*. at 796 (emphasis omitted). Similarly, *Gonzales v. Parks*, 830 F.2d 1033, 1033-36 (9th Cir. 1987), addressed whether a "bankruptcy filing constituted an abuse of process,"

(. . .footnote continued)
defendants could still have argued in state court that field or conflict preemption applied, it is telling that none of them did so. Rather, the docket of the case demonstrates that, after remand by the bankruptcy court, all of the defendants moved to dismiss, and not even one of them asserted preemption as grounds for their motions. *Line Trust Corp. v. Lichtenstein*, Index No. 601951/2009 (Sup. Ct. N.Y. Cty.) (ECF Nos. 12, 16, 46, 67). Of course, this court may take judicial notice of the *Extended Stay* state court docket. *See*, *e.g.*, *Siwek v. Mahoney*, 39 N.Y.2d 159, 163 n.2 (1976) ("Data culled from public records is, of course, a proper subject of judicial notice."); *Wells Fargo Bank, Nat'l Ass'n v. Ballard*, No. 2017-01239, 2019 WL 2274492, at *1 (2d Dep't May 29, 2019) (taking judicial notice of pleading "available electronically on the New York State Courts Electronic Filing System").

and held that a state court claim "based on the filing of a bankruptcy petition" was preempted. Defendants also cited, and the Decision relied on, *Nat'l Hockey League v. Moyes*, No. CV-10-01036-PHX-GMS, 2015 WL 7008213 (D. Ariz. Nov. 12, 2015). But *Moyes* is just another case finding that claims based on an alleged bad-faith bankruptcy filing are preempted. *Id.*, at *5 (preempting claims involving "tortious conduct relating to an attempted unauthorized sale . . . by means of filing bankruptcy," which "amounts to an assertion that the bankruptcy filing was for an improper purpose or in bad faith").[11] *See also MSR Exploration, Ltd. v. Meridian Oil, Inc.*, 74 F.3d 910, 912 (9th Cir. 1996) ("The major issue in this case is whether state malicious prosecution actions *for events taking place within the bankruptcy court proceedings are completely preempted by federal law.*") (emphasis added).[12]

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[11] It was in this context – *i.e.*, a bad-faith bankruptcy filing – that *Moyes* found preemption to be in order because the damages "ar[o]se only after and because of the bankruptcy filing" (*id.*, at *6), reasoning which the Decision apparently found to be persuasive. But this is not a bad-faith bankruptcy filing case. And, again, the Decision ignored that *Extended Stay* found the exact same claims asserted here (tortious interference) resulting in the exact same damages (arising from plaintiff receiving less "favorable treatment . . . in bankruptcy") were *not* preempted. 435 B.R. at 151.

[12] In the same vein, and as defendants themselves have conceded, all of the cases string-cited at pages 9-10 of their brief opposing leave to appeal were "based on bankruptcies" or conduct occurring within bankruptcy proceedings. *See, e.g., In re Repository Techs., Inc.*, 601 F.3d 710, 723-24 (7th Cir. 2010) (claims concerned misuse of the bankruptcy process), *Pertuso v. Ford Motor Credit Co.*, 233 F.3d 417, 426 (6th Cir. 2000) (claims "presuppose[d] a violation of the Bankruptcy Code");

(footnote continued. . .)

Defendants' cases all involve bad faith and abuse of process claims *in a bankruptcy proceeding* for which redress is expressly provided *in the Bankruptcy Code*. Given this, preemption rightly applied to them under the governing principles cited above. That is, any state law claims seeking adjudication of abusive bankruptcy court process or filings could "sharply conflict" with the Bankruptcy Code or create an "obstacle" to carrying out federal bankruptcy policy. Similarly, the Bankruptcy Code and Bankruptcy Rules authoritatively occupy the "field" of

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(. . .footnote continued)
Cox v. Zale Del., Inc., No. 97 C 4464, 1998 WL 397841, at *5 (N.D. Ill. July 13, 1998) (claims "depend[ed] solely upon and thus [were] intricately related to alleged violations of the [Bankruptcy] Code"); *Raymark Indus., Inc. v. Baron*, No. Civ. 96-7625, 1997 WL 359333, at *9-10 (E.D. Pa. June 23, 1997) (claims based on alleged wrongfully filed bankruptcy petition); *Knox v. Sunstar Acceptance Corp. (In re Knox)*, 237 B.R. 687, 702 (Bankr. N.D. Ill. 1999) (claims sought remedies for violations of the Bankruptcy Code); *Holloway v. Household Auto. Fin. Corp.*, 227 B.R. 501, 508 (Bankr. N.D. Ill. 1998) (claim was "wholly dependent upon the Bankruptcy Code"); *Koffman v. Osteoimplant Tech., Inc.*, 182 B.R. 115, 123-25 (Bankr. D. Md. 1995) (claims for abuse of process and malicious prosecution based on alleged violations of the Bankruptcy Code); *Brandt v. Swisstronics, Inc. (In re Shape, Inc.)*, 135 B.R. 707, 708 (Bankr. D. Me. 1992) (claims "relie[d] on the Bankruptcy Code in order to obtain a state law remedy") (emphasis omitted); *Longnecker v. Deutsche Bank Nat. Tr. Co.*, 2013 WL 6700312, at *4 (Iowa Ct. App. 2013) (claims were "premised on litigants' conduct in bankruptcy court"); *PNH, Inc. v. Alfa Laval Flow, Inc.*, 130 Ohio St. 3d 278, 284-85 (Ohio 2011) (claims were based on "misconduct occurring during a bankruptcy proceeding"); *Lewis v. Chelsea G.C.A. Realty P'ship, L.P.*, 862 A.2d 368, 372-73 (Conn. App. Ct. 2004) (claim was based on bad faith filing of adversary proceedings during bankruptcy proceeding). These cases are entirely distinguishable because they are all based on bankruptcy filings themselves, rather than, as here, on pre-petition misconduct that is not based on any actions within the Bankruptcy Cases.

bad-faith bankruptcy filings at issue in the very cases defendants cited below. As observed in one of them:

> Of course, Congress did provide a number of remedies designed to preclude the misuse of the bankruptcy process. *See, e.g.,* Fed. Bankr. R. 9011 (frivolous and harassing filings); 11 U.S.C. § 105(a) (authority to prevent abuse of process); 11 U.S.C. § 303(i)(2) (bad faith filing of involuntary petitions); 11 U.S.C. § 362(h) (willful violation of stays); 11 U.S.C. § 707(b) (dismissal for substantial abuse); 11 U.S.C. § 930 (dismissal under Chapter 9); 11 U.S.C. § 1112 (dismissal under Chapter 11).

MSR Exploration, 74 F.3d at 915; *see also Astor*, 325 F.Supp. 2d at 263 ("Just as the Bankruptcy Code contains a remedy for violations of the automatic stay, it contains remedies for the misuse of the . . . process more generally, and thus such misuse is governed exclusively by that Code") (citation and internal quotation marks omitted).

By the same token, all of defendants' cases concern conduct that is entirely distinguishable from defendants' pre-petition tortious interference here. Unlike those cases, plaintiff alleges neither that Borrowers' decision to file for bankruptcy was improper, nor that it was damaged by anything occurring in the Bankruptcy Cases. As the trial court recognized, "[t]his case does not involve the bankruptcy itself," but, rather, pre-filing conduct that caused Borrowers to breach numerous loan

covenants with plaintiff. (R. 18). Accordingly, the relevant authorities provide no basis for federal preemption of plaintiff's state law tort claims.[13]

D. Preemption Would Deny Plaintiff Any Forum for Its Claims

This lawsuit should not be preempted for the additional reason that it would leave plaintiff without a forum for its tort claims, a strongly disfavored result. *See, e.g., Silkwood v. Kerr-McGee Corp*., 464 U.S. 238, 251 (1984) ("It is difficult to believe that Congress would, without comment, remove all means of judicial recourse for those injured by illegal conduct."); *see also, e.g.*, *Medtronic, Inc. v. Lohr*, 518 U.S. 470, 487 (1996) (it would be "perverse" if "Congress effectively precluded state courts from affording" tort plaintiffs any forum for their claims, and grant "complete immunity" for tortfeasor defendants); *Anderson v. Sara Lee Corp.*, 508 F.3d 181, 192 (4th Cir. 2007) ("the presumption that Congress did not intend to preempt state law . . . is stronger still against preemption of state remedies, like tort recoveries, when no federal remedy exists") (citations and internal quotation marks omitted); *O'Neal v. Capital One Auto Fin., Inc.*, No. 3:10-CV-40, 2011 WL

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[13] In fact, because preemption would deprive plaintiff of any forum for its claims (*see* Section D, below), such a result would be unwarranted even if plaintiff had alleged that the bankruptcy filing itself was actionable. *See Rosenberg v. DVI Receivables XVII, LLC*, 835 F.3d 414 (3d Cir. 2016) (rejecting preemption of tortious interference claim based on filing of involuntary petition for bankruptcy where there was no other forum for the claim). However, since plaintiff's claims are not based on the bankruptcy filing itself, the Court need not reach this issue.

4549148, at *3 (N.D.W. Va. Sept. 29, 2011) ("The presumption against preemption is amplified when federal law does not address the subject regulated by state law and would leave a plaintiff without a remedy.").

Here, if left undisturbed, the Decision would deprive plaintiff of any forum for its claims. This is because the Bankruptcy Court would have no jurisdiction over plaintiff's state law claims, which are asserted against non-debtors and would not affect the administration of any bankruptcy estate. *See, e.g.*, *In re Curtina Int'l*, 15 B.R. 993, 995-96 (Bankr. S.D.N.Y. 1981) (bankruptcy court does not have jurisdiction over claims between non-debtors that "neither [seek] to recover assets for the estate nor from the estate," and "do[] not relate to, or affect[,] the administration of th[e] bankruptcy case"); *see also Schumacher v. White*, 429 B.R. 400, 406 (E.D.N.Y. 2010) (bankruptcy court "has no power to entertain collateral disputes between third parties that do not involve the bankrupt or its property").[14]

This additional reason to deny preemption was completely ignored by the First Department (as well as by defendants in their First Department briefs).

[14] *Accord* Law360 Article at 1 ("This decision, in conjunction with limitations on bankruptcy court jurisdiction, will divest some plaintiffs of a forum for their tort claims against nondebtors. . . .").

E. Policy Considerations Also Strongly Favor Reversal

While the law is clear that preemption is unwarranted here, powerful policy considerations also favor reversal. The loan covenants at issue here provide crucial protection to lenders by ensuring that borrowers are only permitted to conduct business relating to specific real property that is the subject of their loans. Commercial Division Justice Kornreich correctly recognized that it was "important" to plaintiff that Mortgage Borrower remain a single-purpose entity that "would not enter into any other business" besides owning and developing the Property, and that Mezz Borrower was "organized solely for the purpose of acting as a member of the limited liability company that owns the property." (R. 11).

Of course, there is a reason for this. Before the Decision, non-parties who interfered with these covenants to encourage costly and protracted bankruptcies were responsible for the damages they caused. But no longer. With lenders stripped of this protection, Justice Kornreich feared that granting defendants' motion "would undermine the way business is dealt with in New York City when it comes to lenders and developers." (R. 21). This is because the Decision "lay[s] out an unfortunate playbook for developers and insolvent guarantors to seek assistance from third parties in violating their loan covenants to maintain their status as an SPE . . . and

given the lack of reasoning in the First Department's decision, could call into question the efficacy of those provisions." Law360 Article, at 1.[15]

Below, defendants made their own policy argument in favor of preemption. Citing nothing, they cavalierly asserted that "many, probably most, bankruptcies entail breaches of contract," and that the trial court's decision imperiled "anyone who facilitates a bankruptcy, where that bankruptcy entails the breach by the debtor." Nonsense. Holding defendants like these responsible for their tortious interference would not at all burden any debtor's legitimate bankruptcy filing; here, for example, plaintiff never sought and does not seek to file any claim against Borrowers, who were the debtors in the Bankruptcy Cases. Without question, debtors actually hoping to reorganize will continue to finance their bankruptcies in the customary way: namely, by obtaining debtor-in-possession financing under the bankruptcy court's supervision shortly after they file pursuant to 11 U.S.C. § 364.

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[15] Moreover, while the Law360 Article predicts that the Decision will not have what it calls the "earth-shattering consequence[] for the world of real estate finance" of rendering recourse guaranties triggered by bankruptcy filings unenforceable, that optimistic prediction is based only on four trial court decisions. *Id.* at 1, 4 & n.27. If the Decision is affirmed by this Court, these lower court decisions will become irrelevant and the "earth-shattering consequences" feared by the legal and lending communities could well become a reality. *See also* LexBlog Article at 5 (fearing "game-changing consequences on the ability of a lender to collect under . . . a [recourse] guaranty," which "could only have the impact of contracting credit availability across the board . . . and increase barriers to entry into the real estate market").

Reversal would thus provide no impediment to legitimate debtors seeking relief from their creditors through use of the bankruptcy process.

This Court should reverse the Decision, which, as commentators, practitioners and the trial court all have observed, may well turn the Manhattan commercial real estate development industry upside down by scuttling a critical lending tool.

CONCLUSION

For the foregoing reasons, the Decision of the Appellate Division, First Department, should be reversed, the case should be remanded for further proceedings, and plaintiff should be granted such other and further relief as the Court deems proper. Plaintiff further respectfully requests that the Court's Order reversing and remanding makes clear that the case should continue to proceed in Supreme Court during any further appeals by defendants in the First Department.

Dated: New York, New York
July 1, 2019

Respectfully submitted,

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