To be Argued by:
ROBERT S. SMITH
(Time Requested: 15 Minutes)

APL-2019-00028
New York County Clerk's Index No. 654917/16

Court of Appeals
of the
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 DEFENDANTS-RESPONDENTS

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Date Completed: September 24, 2019

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PRELIMINARY STATEMENT

"[N]o *authorized proceeding* in bankruptcy can be … used as the basis for the assertion of a tort claim in state court against any defendant." *Astor Holdings, Inc. v. Roski*, 325 F. Supp. 2d 251, 262 (S.D.N.Y. 2003), quoting *Choy v. Redland Insurance Co.*, 103 Cal. App. 4th 789, 801, 127 Cal. Rptr. 2d 94, 103 (2002). This rule of federal preemption is supported by sound policy, logic and the overwhelming weight of authority, consisting of *Astor*, *Choy* and no fewer than fourteen other decisions by federal and state courts. But the rule is never quoted or discussed in the brief of plaintiff-appellant ("plaintiff"). The reason is obvious: the rule stated in *Astor* and *Choy* controls this case, and requires affirmance of the Appellate Division's order.

Plaintiff's claim is framed as one for inducing breach of contract, but the only tortious acts defendants-respondents ("defendants") are accused of committing consisted of providing help to two debtors in filing their bankruptcy petitions. The only alleged purpose of the transactions sued on was to facilitate bankruptcy filings, and plaintiff's only claimed injuries are delay and attorneys' fees generated by those filings. It is beyond dispute that that the bankruptcy proceedings are being "used as the basis" for the assertion of plaintiff's tort claim. The claim is therefore preempted.

The Appellate Division's decision, like *Astor*, *Choy* and many others reaching the same result on analogous facts, vindicates an important federal policy: to protect the proper functioning of the bankruptcy laws. Permitting creditors to bring state-court litigation against parties that facilitated a bankruptcy, and to recover the damages allegedly inflicted by bankruptcy proceedings, would chill bankruptcy filings and deprive debtors of the protection to which federal law entitles them. The remedy for a creditor who thinks the bankruptcy process has been abused is in the Bankruptcy Courts, which have power to dismiss filings for abuse – a remedy that plaintiff here initially sought, but chose not to pursue.

Plaintiff offers no justification for its forum-shopping, and no convincing distinction for the cases applying preemption to similar tort claims. Instead, plaintiff resorts to distraction. It says that the Appellate Division's straightforward decision, supported by more than ample precedent, will "hamper real estate development in New York" (Brief for Plaintiff-Appellant ("Pl. Br.") at 2), leaving real estate lenders the prey of "unscrupulous vulture capitalists" (*id.* at 3). There is no basis for those predictions of doom. Citing a trade publication known for its friendliness to plaintiff's principal, plaintiff claims that the decision "has not been well received" (*id.*at 2), but the rest of the real estate community has reacted with unconcern, or not at all.

It could hardly be otherwise, because the Appellate Division did no more than apply to very clear facts the same principle that courts in similar cases have been applying for decades. There would be greater reason for alarm had the decision gone the other way, for that would impair the long-prevailing balance between creditors and debtors that has been, and should be, the special province of federal Bankruptcy Courts.

The order of the Appellate Division should be affirmed.

QUESTION PRESENTED

Is a state-law tort case based upon actions taken to facilitate bankruptcy proceedings, and seeking damages allegedly caused by those proceedings, preempted by the United States Bankruptcy Code?

THE FACTS

Plaintiff, a creditor, sought to foreclose on its collateral, prompting two related debtors to file bankruptcy proceedings. The bankruptcies were successfully completed, with plaintiff's support, and plaintiff got the result it wanted, control of a major real estate project. But plaintiff says that, but for the bankruptcies, it could have obtained that result more cheaply and quickly. It is therefore suing defendants

here for engaging in two transactions that, plaintiff alleges, caused the bankruptcies to happen.

A. The Loans

By three similar agreements dated as of June 19, 2015 (the "Loan Agreements"), plaintiff, Sutton 58 Associates LLC, made loans totaling $147,250,000 to finance a planned residential apartment project at Sutton Place and East 58th Street in Manhattan (the "Project"). (R52, 59, 818-1014)[1] The borrowers were two limited liability companies (collectively the "Borrowers"): Sutton 58 Owner LLC, the owner of the real property on which the Project would be constructed ("Mortgage Borrower"), and Mortgage Borrower's sole member, BH Sutton Mezz LLC ("Mezz Borrower"). (R57-58) The owners of the Borrowers were individuals and a trust unrelated to any of the parties in this case. (*Id.*)

The Loan Agreements contained a number of covenants and other provisions typical in transactions of this kind. (R 836-49, 854, 898-906, 912, 958-966, 972) Two of them (italicized below) were obviously designed to keep the Borrowers out of bankruptcy, and plaintiff claims that a number of others were breached when the Borrowers filed for bankruptcy. The complaint summarizes the relevant contract terms as follows:

> Mezzanine Borrower and Mortgage Borrower each agreed: (a) *not to file a petition for bankruptcy*; (b) not to

[1] "R" refers to the Record on Appeal.

> incur debt other than "Permitted Indebtedness"; (c) to pay their liabilities out of their own funds and assets; (d) not to have assets or businesses unrelated to the Property; (e) not to make, permit, or suffer the sale or transfer of an indirect interest in Mezz Borrower or Mortgage Borrower, respectively; (f) to consider the interests of plaintiff in connection with all corporate actions; (g) *to remain a special purpose bankruptcy remote entity*; and (h) that any event of default under one Loan Agreement would be an event of default under the other Loan Agreements.

(R59; emphasis added.)

B. The Bankruptcy Filings

The Borrowers' loans were not paid on their maturity date, and plaintiff began proceedings to foreclose on the collateral Mezz Borrower had pledged to it, a 100% interest in Mortgage Borrower. (R62.) After an unsuccessful attempt to get an injunction against the foreclosure, Mezz Borrower filed a voluntary bankruptcy petition in the United States Bankruptcy Court for the Southern District of New York on February 26, 2016. (R79-82) Mortgage Borrower filed its petition several weeks later, on April 6, 2016. (R103-109)

C. The Alleged Tortious Acts

Defendants are a corporation, Prime Alliance Group, Ltd. ("Prime Alliance"); a limited liability company, Sutton Opportunity LLC ("Sutton Opportunity"); and the individuals who own and manage these entities, Philip Pilevsky and his sons Michael and Seth Pilevsky. (R56) Plaintiffs claim that at

some point before the bankruptcy filings defendants and the Borrowers entered an arrangement or "scheme" whereby defendants would "obtain an ownership interest" in the proposed Project. Plaintiff asserts that "the Pilevsky Scheme had two parts." (R53) These two "parts" – the tortious acts defendants are accused of committing – were transactions that, as described by plaintiff, had only one purpose and one significant effect: to enable the Borrowers to file for bankruptcy.

The first of these alleged acts consisted of loaning money to Mezz Borrower so that it could hire a bankruptcy lawyer. Plaintiff alleges: "Philip Pilevsky caused Prime Alliance to lend Mezz Borrower $50,000…to retain a law firm…to file a petition for bankruptcy…." (*Id.*) The second alleged wrong was to transfer property to Mortgage Borrower so as to facilitate Mortgage Borrower's bankruptcy filing. The complaint explains that Mortgage Borrower was previously a "Single Asset Real Estate Entity" and therefore "faced a formidable obstacle in using bankruptcy" because the Bankruptcy Code "disfavors" filings by such entities. (R53-54) Plaintiff asserts that "Michael Pilevsky and Seth Pilevsky caused Sutton Opportunity to transfer three rental apartments" to Mortgage Borrower so that Mortgage Borrower would no longer own only a "Single Asset". (*Id.*) According to the complaint this was an attempt to "evade" and "dodge" what the complaint calls "a fundamental protection of plaintiff under bankruptcy law". (*Id.*) But plaintiff

never chose to litigate the validity of Mortgage Borrower's filing in the Bankruptcy Court.

D. The Proceedings in Bankruptcy Court

On March 10, 2016, plaintiff moved in the Bankruptcy Court to dismiss Mezz Borrower's bankruptcy petition on the ground that it was a "bad-faith filing". (R1151) After the Bankruptcy Judge commented unfavorably on the motion during oral argument (R121: "my initial impression is, you're asking for relief...that could only be given if I adopt your view of the case"), it was withdrawn without prejudice by agreement. (R163 [#82]) The motion in Mezz Borrower's case was never renewed, and plaintiff never moved to dismiss Mortgage Borrower's bankruptcy filing.

Instead, the two bankruptcies were combined, and plaintiff and the Borrowers cooperated with a creditors' committee appointed by the Bankruptcy Court to develop a plan of reorganization in which plaintiff obtained control of the Project. (R487-534) The plan, dated November 14, 2016, was filed jointly by plaintiff and the creditors' committee (R588-589), was supported by the Borrowers, and was approved by the Borrowers' creditors without a dissenting vote (R680-682). The creditors' committee, in certifying the vote to the Bankruptcy Court, represented that plaintiff ("[t]he Class 2 claimant") "has

accepted the Plan". (R681) The plan was confirmed by the Bankruptcy Court on January 18, 2017. (R600-678)

E. The Alleged Injury to Plaintiff

Although the outcome of the bankruptcies was that plaintiff controlled the Project, plaintiff complains that that result would have come sooner, and the Project would be more lucrative, if the bankruptcies had never been filed. The "delay" attendant on the bankruptcies, the complaint says, "has damaged and continues to damage plaintiff" in two ways: it gave "[c]ommunity opponents of the Project" a chance to advance a proposed rezoning of the property; and the Project suffered from "declining prices and troubles in the market". (R73) Plaintiff adds that it "has paid significant attorneys' fees and has incurred other costs". (R74) It is plain from the complaint that the alleged delay, attorneys' fees and costs resulted from the bankruptcies. No other injury is alleged.

THE DECISIONS BELOW

This action was commenced on September 16, 2016, while the bankruptcies were still pending. Defendants moved for summary judgment on the ground, among others, that the action was preempted by the Bankruptcy Code. (R43) Supreme Court denied the motion in an oral opinion. (R7-33) The court said that "the loan papers are similar to loan papers I see all the time" (R10), and told defendants' counsel: "What you are asking me to do is to throw this out, upend the

way contracts are written here in New York City and upend the whole development industry...." (R15)

Supreme Court did not address an essential part of defendants' argument. These loan covenants are indeed common and no one is asking to "throw [them] out", but it is also true that bankrupt debtors default on their loan covenants "all the time", and the bankruptcy laws limit the extent to which the covenants can be enforced. Defendants' point is that creditors should not be allowed to evade those federal-law limitations by making the loan covenants the basis for an action against third parties in state court. Supreme Court's opinion is silent on this subject.

The Appellate Division unanimously reversed and granted defendants' motion for summary judgment on preemption grounds. (R 1564-1565) The court relied on two of the many cases finding preemption on similar fact patterns, *Astor* and *National Hockey League v. Moyes*, 2015 WL 7008213 (D. Ariz. Nov. 12, 2015) (discussed at pages 16-18 and 20 below). It distinguished a case cited by plaintiff, *Davis v. Yageo Corp.*, 481 F.3d 661 (9th Cir. 2007) (discussed at pages 25-26 below). The court also observed that "in the bankruptcy proceedings, plaintiff moved to dismiss Mezz Borrower's petition as filed in bad faith but voluntarily withdrew that motion." (R1564)

ARGUMENT

THE BANKRUPTCY CODE PREEMPTS PLAINTIFF'S CLAIMS

Plaintiff claims that if defendants had not "induced" the Borrowers to breach their contracts, the Borrowers would never have filed bankruptcy proceedings. But in filing those proceedings, the Borrowers were exercising a right given them by the federal Bankruptcy Code. Plaintiff alleges that the Borrowers were abusing the bankruptcy process – but that was a matter for the Bankruptcy Court to decide.

Plaintiff moved in Bankruptcy Court to dismiss Mezz Borrower's bankruptcy case on the ground it was filed in bad faith (R1151), but plaintiff withdrew that motion after the Bankruptcy Judge made a skeptical comment about it. (R121, 163) Plaintiff's complaint here says that Mortgage Borrower's bankruptcy was an effort to "evade" or "dodge" the restrictions on bankruptcy filings by Single Asset Real Estate Entities (R53-54), but plaintiff chose not to make that argument to the Bankruptcy Court. It never moved to dismiss Mortgage Borrower's bankruptcy case, but instead cooperated in working out a plan to resolve the bankruptcies – a plan plaintiff supported in Bankruptcy Court, and from which it got what it wanted, control of the Project. (R487-534)

The law is clear that, having forgone any challenge to the validity or legitimacy of the Borrowers' bankruptcy filings in Bankruptcy Court, plaintiff cannot make such a challenge in a state-law tort action. Nor can it base a state law

tort claim on filings that were legitimate and valid under federal law. The claims it makes in this case are therefore preempted by the Bankruptcy Code.

To demonstrate this, we will first discuss general principles of federal preemption (pp. 12-16 below), and secondly the many cases that apply those principles to state-law tort actions based on bankruptcy filings (pp. 16-26). Thirdly, we will show that the case on which plaintiff chiefly relies, *In re Extended Stay*, 435 B.R. 139 (S.D.N.Y. 2010), has nothing to do with the issue in this case (pp. 26-30). We will then respond briefly to plaintiff's other arguments (pp. 30-36).

A. Basic Principles of Federal Preemption Support its Application Here

Federal preemption of state law "has its roots in the Supremacy Clause", Article VI, clause 2 of the United States Constitution. *Fid. Fed. Sav. & Loan Ass'n v. de la Cuesta*, 458 U.S. 141, 152-153 (1982). Several forms of preemption have been recognized, of which two are relevant here. "Conflict preemption" occurs where a state law is inconsistent with federal law or "stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress". *E.g., Ray v. Atl. Richfield Co.,* 435 U.S. 151, 158 (1978), quoting *Hines v. Davidowitz*, 312 U.S. 52, 67 (1941). "Field preemption" occurs where "federal law so thoroughly occupies a legislative field as to make reasonable the inference that Congress left no room for the States to supplement it." *E.g., Cipollone v. Liggett*

Grp., Inc., 505 U.S. 504, 516 (1992) (internal citations omitted). This case is an example of both conflict preemption and field preemption.

(1) Conflict Preemption

"[A] central purpose of the [Bankruptcy] Code is to provide a procedure by which certain insolvent debtors can reorder their affairs, make peace with their creditors, and enjoy 'a new opportunity in life with a clear field for future effort, unhampered by the pressure and discouragement of preexisting debt.'" *Grogan v. Garner*, 498 U.S. 279, 286 (1991) quoting *Local Loan Co. v. Hunt*, 292 U.S. 234, 244 (1934). State-law causes of action that make bankruptcy filings difficult or impossible are subject to conflict preemption because they "stand[] as an obstacle" to that purpose – and actions like this one for inducing breach of contract, brought against third parties who did nothing more than facilitate or encourage a bankruptcy filing, present a particular threat.

In many, perhaps most, cases a debtor who files a bankruptcy petition will be breaching contractual obligations. As Supreme Court correctly observed, provisions like those plaintiff relies on here are encountered "all the time" in loan agreements. (R10) Thus, many agreements, like those in this case, provide that a bankruptcy filing is an event of default under the loan (R854, 912, 972); require the debtor to maintain a status inconsistent with a successful bankruptcy (R839-840, 901, 961); and prohibit or severely restrict the incurring of more indebtedness

or the use of funds other than the debtor's own (R840, 875, 902, 934, 962, 1015) – even though some new financing will often, as in this case, be indispensable to a bankruptcy filing. To state the obvious, debtors who file for bankruptcy are usually short of money.[2] Debtors who need, as Mezz Borrower here did, to borrow money to hire a bankruptcy lawyer can hardly be rare. It will very often be simply impossible for a debtor to file for bankruptcy without violating loan covenants.

If plaintiff's claim here is upheld, anyone who facilitates a bankruptcy, where that bankruptcy entails the breach by the debtor of loan covenants or other contractual obligations, is at risk. A lender, like Prime Alliance, that does nothing more than lend money so that a debtor can hire a bankruptcy lawyer can be sued by the debtor's creditors for any adverse consequences they suffer from the bankruptcy. An investor, like Sutton Opportunity, that makes a deal with a prospective debtor in contemplation of a bankruptcy filing, and, as a predicate to that filing, enters a transaction contrary to a loan covenant could be sued also. The result, inevitably, will be that many debtors will not get the financial or other help they need to file bankruptcies.

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[2] *See, e.g.*, Kiel, Paul, "What Happens When You Can't Afford to Go Bankrupt," The Washington Post, Mar. 2, 2018 (*available at*: https://beta.washingtonpost.com/outlook/what-happens-when-you-cant-afford-to-go-bankrupt/2018/03/02/343fd882-1d8e-11e8-9de1-147dd2df3829_story.html) ("why bankruptcy often fails those it's supposed to help: … People are too broke to go bankrupt. Filing costs money, as does hiring an attorney….Those who can't afford attorneys often turn to bad options with predictably bad outcomes.").

This chilling of bankruptcies would shift the creditor-debtor balance in creditors' favor – and not only in the world of commercial real estate, though that would be a significant problem in itself. It would adversely affect all potential debtors, including individual consumers and borrowers who depend on the bankruptcy laws to protect them from predatory merchants and lenders. *See* Robert M. Lawless, Angela K. Littwin, *et al.*, *Did Bankruptcy Reform Fail? An Empirical Study of Consumer Debtors*, 82 Am. Bankr. L.J. 349, 405 (2008) (making "access to bankruptcy more difficult for all, [would] impos[e] new costs and hurdles … pricing the worst off out of the system"); Elizabeth Warren, *A Principled Approach to Consumer Bankruptcy*, 71 Am. Bankr. L.J. 483, 507 (1997) ("Some debtors need help, and their access to effective help should be carefully preserved."). If plaintiff's claim here is allowed to proceed, it will open the door to creditor suits against non-profit organizations and pro bono lawyers who have helped individual debtors to go bankrupt, if those debtors have, in the course of doing so, breached any terms in the documents they signed.[3]

In short, to allow state-law court suits like the present one would frustrate the central purpose of the Bankruptcy Code – to give qualifying debtors an

[3] *See, e.g.*, "For Legal Organizations, Upsolve Offers a Way to Do Bankruptcies 10 Times Faster and Help More People," Legal Services Corp. (*available at*: https://www.lsc.gov/grants-grantee-resources/resources-topic-type/legal-aid-organizations-upsolve-offers-way-do) (Describing Upsolve.com, a non-profit whose "mission is to help low-income Americans in financial distress get a fresh start" through bankruptcy).

opportunity to clean up their debts and make a fresh start. Thus, this is a case of conflict preemption.

(2) Field Preemption

This is also a case of field preemption. The Bankruptcy Code is a classic example of comprehensive federal regulation that thoroughly occupies a legislative field. The federal regulatory scheme is disrupted when a creditor of a bankrupt entity can seek a state-court remedy against a third party for alleged "wrongs" that consisted of facilitating the bankruptcy, and tries to recover all the loss that the bankruptcy proceeding allegedly caused. If the sort of activity that forms the basis for this lawsuit is to be regulated, it is for the federal courts, interpreting the commands of Congress, to decide the extent of the regulation – what is permitted, what is prohibited, and what remedies are available. It is not consistent with uniform enforcement of nationwide bankruptcy laws for 50 states to make their own separate judgments on what is or is not lawful assistance to an entity that wants to file for bankruptcy, or what if any damages shall be available to creditors who claim that a bankruptcy filing injured them.

B. The Relevant Cases Overwhelmingly Support Preemption of State-Law Claims Based on Bankruptcy Filings

(1) Cases Finding Preemption

The overwhelming majority of courts that have considered the question – sixteen out of eighteen, not counting the Appellate Division here – have held that

state-law tort claims based on bankruptcy filings are preempted by the Bankruptcy Code.

Astor – a case resembling this one, decided in 2003 by then United States District Judge Gerard Lynch, now on the Second Circuit Court of Appeals – is a good example. There a creditor, Astor, claiming injury resulting from the bankruptcy of one Thorpe, sued Roski, claiming that Roski had "tortiously interfered with … contractual agreements Astor had executed with Thorpe." 325 F. Supp. 2d at 253. The tort claim was based on New York law. *Id.* at 259.

Thorpe and Astor were parties to a contract giving each a 50% interest in a business known as Robot Wars. Astor claimed that Thorpe had breached the contract by (among other things) "fil[ing] for bankruptcy in an effort to divest [Astor] of its interest in the Robot Wars business" and that Roski had induced him to do so. *Id.* at 259-260 (quoting Astor's complaint; alterations by the *Astor* court). The record showed that Roski, for reasons of his own, had been "helping Thorpe to free himself from the [contractual] relationship with Astor." *Id.* at 256. To that end, Roski caused his family's law firm to "become involved" with the Thorpe-Astor dispute. *Id.* A lawyer at that firm "suggested that Thorpe file for bankruptcy." *Id.* at 257.

Judge Lynch granted summary judgment dismissing the complaint, holding that Astor's claims against Roski, insofar as they were based on Thorpe's

bankruptcy filing, were preempted by federal law. The court relied on "the broad scope of federal bankruptcy preemption" described by the Second Circuit Court of Appeals in *Eastern Equipment & Services Corp. v. Factory Point National Bank*, 236 F.3d 117, 121 (2d Cir. 2001). *Id.*at 262. The *Astor* court quoted the factors considered by the *Eastern Equipment* court as favoring preemption:

> (1) Congress placed bankruptcy jurisdiction exclusively in the [federal] district courts under 28 U.S.C. § 1334(a); (2) Congress created a lengthy, complex and detailed Bankruptcy Code to achieve uniformity; (3) the Constitution gives Congress exclusive jurisdiction over the bankruptcy law, see U.S. Const. art. I, § 8, cl. 4; (4) the Bankruptcy Code establishes several remedies designed to preclude the misuse of the bankruptcy process; and (5) *the mere threat of tort actions could prevent individuals from exercising their rights in bankruptcy, thereby disrupting the bankruptcy process*.

236 F.3d at 121, quoted 325 F. Supp. 2d at 262 (emphasis added).

The *Astor* court also relied on the decision of a California Court of Appeal in *Choy v. Redland Insurance Co.*, 103 Cal. App. 4th 789, 801, 127 Cal. Rptr. 2d 94, 103 (2002), and quoted with approval the *Choy* court's statement of its holding: "no *authorized proceeding* in bankruptcy can be questioned in a state court *or used as the basis for the assertion of a tort claim in state court against any defendant.*" (Quoted in *Astor*, 325 F. Supp. 2d at 262; second emphasis added.) In *Choy*, the plaintiff in a personal injury case alleged that the defendant corporation's liability insurer had caused the defendant to go bankrupt solely to prevent the entry of a

judgment against the defendant that would then be the basis for a bad-faith claim against the insurer. It was alleged that the insurer "paid all the necessary filing fees" for the bankruptcy, "so that [the insurer] could avoid liability for its bad faith conduct." 103 Cal. App. 4th at 794, 127 Cal. Rptr. 2d at 97. The court held the plaintiff's action against the insurer to be preempted, relying among other authorities on *MSR Exploration, Ltd. v. Meridian Oil, Inc.*, 74 F.3d 910, 914 (9th Cir. 1995), which warned against "state courts, in effect, interfering with the whole complex, reticulated bankruptcy process itself."

The *Choy* court also relied on *Gonzales v. Parks*, 830 F.2d 1033 (9th Cir. 1987). There a creditor, Parks, sought to foreclose on property owned by Richard and Juliana Gonzales, but was prevented from doing so when the Gonzaleses filed a bankruptcy petition. Parks brought suit in state court, claiming that the bankruptcy was an abuse of process and naming as defendants not only the Gonzaleses but also Dodge, the attorney who helped the Gonzaleses file the bankruptcy petition. A federal bankruptcy court held the state court action as brought against all three defendants – including Dodge, who was not a party to the bankruptcy – "void from the outset" because it was preempted by the Bankruptcy Code. *See id.* at 1036. A district court and the Ninth Circuit Court of Appeals affirmed that holding.

A state-law tort claim based on an injury resulting from bankruptcy is preempted even where, as here, the defendants' allegedly tortious conduct occurred prior to the bankruptcy filing. This principle is illustrated by *Astor* and *Choy*, among other cases, and is explicitly stated in *National Hockey League v. Moyes*, 2015 WL 7008213 (D. Ariz. Nov. 12, 2015). There the NHL sued the "Moyes Parties", controlling owners of the Coyotes professional hockey team, alleging that the Moyes Parties had aided and abetted a breach of fiduciary duty by the Coyotes in entering into an agreement to sell the team to a purchaser who planned to move it to Canada. The agreement "required authorization from a bankruptcy court before the sale could be finalized", so the Moyes Parties caused the companies that owned the Coyotes to file bankruptcy proceedings. *Id.* at *2. The court held the NHL's tort claim to be preempted, rejecting the argument that "to the extent [the] tort claim comprises pre-filing conduct, the claim is not preempted." *Id. at* *5. The court held that "[w]hen damages arise only after and because of the bankruptcy filing, a claim based on pre-filing conduct is preempted." *Id.* at *6. That rule requires preemption here.

The court in *National Hockey League* cited *Casden v. Burns*, 504 F. Supp. 2d 272, 281-282 (N.D. Ohio 2007), *aff'd* 306 F. Appx. 966 (6th Cir. 2009), in which a claim for breach of fiduciary duty against a corporation's directors was held preempted, where the directors had allegedly caused the corporation to file a

bankruptcy petition to protect themselves from shareholder claims. The *Casden* court explained: "Where, as here, injury to shareholders might never occur, and thus plaintiff's claim would not accrue, if at all, until after the company files its bankruptcy petition, and accrual of the claim depends on what happens in the Bankruptcy Court, the potential future claim would interfere sufficiently with the bankruptcy process to trigger preemption." 504 F. Supp. 2d at 281. This holding applies to the present case: the injury of which plaintiff complains would never have accrued but for the Mezz Borrower and Mortgage Borrower bankruptcy filings, the accrual of the claim depended on what happened in the Bankruptcy Court, and therefore the claim "would interfere sufficiently with the bankruptcy process to trigger preemption."

Other cases holding state-law tort claims that arose out of bankruptcy filings to be preempted include: *In re Repository Techs., Inc.*, 601 F.3d 710, 720-23 (7th Cir. 2010) (state law claims of tortious interference, based on allegation that defendants "caus[ed] RTI to file for bankruptcy," "concern[ed] the defendants' conduct before the official commencement of RTI's bankruptcy case" but were "inextricably bound to the bankruptcy proceeding," and thus could be "preempted by the [Bankruptcy] Code to preclude the misuse of the bankruptcy process.") (internal quotation marks omitted); *Pertuso v. Ford Motor Credit Co.*, 233 F.3d 417, 426 (6th Cir. 2000) (state law claims for unjust enrichment brought against

secured creditor who had collected debts from plaintiffs during pendency of bankruptcy proceedings were preempted because they "presuppose a violation of the Bankruptcy Code"); *Cox v. Zale Del., Inc.*, 1998 WL 397841 *6 (N.D. Ill. July 13, 1998) (debtor's claims for unfair debt collection and unjust enrichment, based on debt collection agreements signed with creditor during pending bankruptcy, were preempted); *Raymark Indus., Inc. v. Baron*, 1997 WL 359333 *10 (E.D. Pa. June 23, 1997) (Raymark's state law claims based upon the filing of a bankruptcy petition were preempted; a finding to the contrary would "lead to a world where the specter of additional litigation must haunt virtually every actor in a bankruptcy proceeding."); *Knox v. Sunstar Acceptance Corp. (In re Knox)*, 237 B.R. 687, 702 (Bankr. N.D. Ill. 1999) (claim brought pursuant to the Illinois Consumer Fraud Act essentially seeking remedies for violations of the Bankruptcy Code was preempted by the Bankruptcy Code); *Holloway v. Household Auto. Fin. Corp.*, 227 B.R. 501, 508 (Bankr. N.D. Ill. 1998) (claim under the Illinois Consumer Fraud and Deceptive Practices Act was preempted because the "claim is wholly dependent upon the Bankruptcy Code"); *Koffman v. Osteoimplant Tech., Inc.*, 182 B.R. 115, 125 (Bankr. D. Md. 1995) (disallowing state tort actions based on violations of the Bankruptcy Code because to allow them "ultimately would have the effect of permitting state law standards to modify the incentive structure of the Bankruptcy Code and its remedial scheme"); *Brandt v. Swisstronics, Inc. (In re Shape, Inc.)*,

135 B.R. 707, 708 (Bankr. D. Me. 1992) (where the Bankruptcy Code "is applicable ... and has its own enforcement scheme and separate adjudicative framework, it must supersede any state law remedies"); *Longnecker v. Deutsche Bank Nat. Tr. Co.*, 842 N.W.2d 680 (Iowa Ct. App. 2013) (finding that claims of tortious interference against mortgagor who defaulted on mortgage and repeatedly filed bankruptcy petitions to stall foreclosure were preempted and noting that "the mere possibility of being sued in tort in state court" could "deter persons from exercising their rights in bankruptcy"); *PNH, Inc. v. Alfa Laval Flow, Inc.*, 130 Ohio St. 3d 278, 284-85, 958 N.E.2d 120, 126-27 (2011) (finding that state law claims for abuse of process and tortious interference based on misconduct that allegedly occurred during a bankruptcy proceeding were preempted); *Lewis v. Chelsea G.C.A. Realty P'ship, L.P.* 862 A.2d 368, 372-73 (Conn. App. Ct. 2004) (finding that plaintiff's state tort claims were preempted by the Bankruptcy Code and stating that "the threat of such tort actions and the potential for a large recovery may itself deter individuals from exercising their rights in bankruptcy").

Plaintiff's brief in this Court struggles to distinguish all of these cases. (Pl. Br. at 27-31) As to several of them, including *Astor*, *Choy*, *Gonzales* and *National Hockey League*, the main "distinction" the brief offers is that in each the state-law case was "based on an alleged bad-faith bankruptcy filing". (Pl. Br. at 28) But this is no distinction, because the same is true here. The complaint here does not

actually use the words "bad faith", but plaintiff did use those words in Bankruptcy Court, speaking of a "classic bad-faith filing". (R1151). Plaintiff's complaint instead uses synonyms for bad faith, referring repeatedly to "the Pilevsky Scheme" (R53, 54, 55, 57, 58, 68, 70, 72, 73, 74) whose aim was to "evade a fundamental protection … under bankruptcy law" (R53) and "dodge ... Bankruptcy Code provisions" (R54). And in any event, the proposed distinction is an absurd one: it implies that claims based on alleged bad-faith filings are preempted while those based on good-faith filings are not. But good-faith filings should if anything have *more* protection, not less. Plaintiff offers no authority and no logic that could support its proposed rule of preferential treatment for bad-faith claims.

Plaintiff says that the cases defendants rely on were not based on alleged "pre-petition misconduct" (Pl. Br. at 29 n.12), but, as explained above, many of them were, and the *National Hockey League* and *Casden* cases state explicitly their holdings that claims based on conduct preceding a bankruptcy petition may be preempted. Plaintiff also offers the odd argument that "as defendants themselves have conceded" the cases defendants have relied on "were 'based on bankruptcies'." (Pl. Br. at 28 n.12) Of course they were, and so is this one.

Plaintiff never quotes, or addresses in any way, the principle clearly stated by the California Court of Appeal in *Choy* and endorsed by Judge Lynch in *Astor*: "no *authorized proceeding* in bankruptcy can be questioned in a state court or used

as the basis for the assertion of a tort claim in state court against any defendant." 103 Cal. App. 4th at 81, 127 Cal. Rptr.2d at 103, quoted with approval in *Astor*, 325 F. Supp.2d at 322. That principle is controlling here.

(2) Cases Rejecting Preemption

Plaintiff relies on two cases that, in contrast to the many others we have cited, seem to deviate from the *Choy/Astor* principle: *Davis v. Yageo Corp.*, 481 F.3d 661 (9th Cir. 2007) and *F.D.I.C. v. Barton*, 1998 WL 169696 (E.D. La. April 8, 1998). *See* Pl. Br. at 22-23.

Both *Davis* and *Barton* involved very unusual facts. In *Davis* the state-law claims sued on had been specifically preserved as part of a confirmed plan approved by the Bankruptcy Court and had been assigned to the plaintiffs with Bankruptcy Court approval. 481 F.3d at 668. In *Barton*, the bankruptcy filing had been made while the debtor was party to a restrictive agreement with federal bank regulators, and without notice to the regulators. 1998 WL 169696 at *1, *2. Both cases contain loose language, but they cannot fairly be read as anything but rare exceptions to the general rule stated in *Choy* and *Astor* and reflected in the overwhelming weight of authority we have cited: authorized proceedings in a Bankruptcy Court cannot be the basis for a state-law tort claim.[4]

[4] Plaintiff also relies on a completely inapposite case, *Dougherty v. Wells Fargo Home Loans, Inc.*, 425 F. Supp. 2d 599 (E.D. Pa. 2006) (*see* Pl. Br. at 24). The plaintiff there was not

C. *In re Extended Stay* Decided a Different Issue that is Irrelevant to this Case

Plaintiff relies heavily on *In re Extended Stay*, 435 B.R. 139 (S.D.N.Y. 2010), saying that "[i]ts relevance here cannot be overstated." (Pl. Br. at 1, 26) In fact, *Extended Stay*'s relevance here is non-existent, because that case involved "complete preemption" (i.e., whether a federal court has exclusive jurisdiction to decide a preemption issue, a question not presented here), and not "ordinary preemption" (i.e., whether a state law claim is or is not preempted by federal law, which *is* presented here). Thus *Extended Stay* involved only the question of which court has jurisdiction to decide whether a case is preempted; it did not involve the merits of a federal preemption defense. The *Extended Stay* court itself carefully pointed out this distinction, in a part of its opinion that plaintiff chooses not to discuss.

The "complete preemption/ordinary preemption" distinction exists because a claim subject to ordinary preemption by federal law is not usually within the exclusive jurisdiction of the federal courts. Where a state-court complaint is based on state law, and a defendant asserts that the claim is preempted by federal law (ordinary preemption), the state court has jurisdiction to decide the issue and the case normally cannot be removed to federal court. That is what happened here.

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complaining about a bankruptcy proceeding – she was the debtor who had filed it. *See* 425 F.Supp.2d at 601.

Defendants did not try to remove this case to federal court – and if they had, the federal court might well have sent it back, permitting the state court to rule on the ordinary preemption defense. That would not mean that the defense was invalid, but only that the state court, not the federal court, should decide it.

"Complete preemption" is a rare exception to the rule that federal preemption defenses in state-court cases are to be decided by the state courts. Cases are *completely* preempted when they are so intertwined with federal law that only federal courts can decide them. ("Complete preemption" is also known as "arising under" preemption, because cases that are completely preempted are held to "arise under" federal law.) "Complete preemption" is what *Extended Stay* was about. But no one is saying that complete preemption applies in this case.

As Judge Swain said in *Extended Stay*, courts have drawn

> a careful demarcation between ordinary preemption … and complete preemption, which creates federal subject matter jurisdiction over preempted state-law claims …. *Ordinary preemption, even when it eviscerates a state law claim, does not provide a basis for federal court jurisdiction of the state law claim,* and a plaintiff's suit does not arise under federal law simply because the defendant may raise the defense of ordinary preemption.

435 B.R. at 149-150 (emphasis added; internal quotation marks and citations omitted).

In other words, a case that is not subject to "complete preemption" – i.e., one that does not give rise to federal *jurisdiction* - may still be preempted in the ordinary sense by federal law.

Extended Stay involved an attempt by parties sued in three state-court actions to remove their cases to federal court. *Id.* at 145. Judge Swain remanded two of the actions, a contract case and a tort case, to state court on the ground that "complete preemption" was lacking – i.e., the federal courts lacked jurisdiction over these actions because they were not cases "arising under" the Bankruptcy Code. *See* 28 U.S.C. § 1334(b). Judge Swain said, quoting *MSR Exploration, Ltd. v. Meridian Oil, Inc.,* 74 F.3d 910, 912 (9th Cir. 1996), that "preemption assertions are normally matters of defense and will not suffice to establish federal jurisdiction." 435 B.R. at 149. As to the *tort* case in *Extended Stay* – the only one arguably relevant here – Judge Swain held only that "Appellants' *preemption based 'arising under'* arguments fail". *Id.* at 151 (emphasis added). The words "preemption based 'arising under' arguments", as the *Extended Stay* court explained, mean, "complete preemption arguments" – i.e., jurisdictional arguments. The *Extended Stay* opinion neither said nor suggested anything about the ordinary preemption defense as it applies to state-law tort claims. Plaintiff's brief ignores Judge Swain's meticulous explanation of this distinction, using the

quoted words "preemption-based arising under arguments" as though they meant the same thing as "ordinary preemption arguments". (Pl. Br. at 25)

Plaintiff deals with the distinction between "complete" (or "arising under") preemption and ordinary preemption only in a footnote, which utterly fails to make the distinction disappear. (*See* Pl. Br. at 26-27 n.10) Plaintiff says:

> 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) …, the very cases upon which defendants purport to rely, but now must necessarily concede are inapposite based on their own argument.

Id. at 26 n.10.

This sentence is riddled with errors. *MSR* is indeed a complete preemption case, but *Astor* is not. Judge Swain distinguished *MSR* because the claim in *MSR*, unlike those in *Extended Stay*, warranted complete preemption – i.e., it arose under federal law and was subject to the exclusive jurisdiction of federal courts. 435 B.R. at 146. Judge Swain also distinguished *Astor* – because *Astor*, unlike *Extended Stay*, did not decide a jurisdictional (complete preemption) issue. Judge Swain said: "It appears that jurisdiction in *Astor Holdings* was not premised on 28 U.S.C. § 1334," the "arising under" bankruptcy-jurisdiction statute on which the defendants in *Extended Stay* relied. 435 B.R. at 148 n.2. In other words, Judge

Swain made the same point we are making here: *Extended Stay* was a case about federal jurisdiction, while *Astor* was a case about an ordinary preemption defense. This case is like *Astor*, and unlike *Extended Stay*.

Plaintiff's only other comment on the clear distinction between this case and *Extended Stay* is that "while [defendants] claimed that *Extended Stay* left open the possibility that the Line Trust and other defendants could still have argued in state court that field or conflict preemption applied, it is telling that none of them did so." (Pl. Br. at 26-27 n.10) This requires little response. The failure of parties in a different case, for unexplained reasons, to make an argument that might or might not have had merit is not even weak authority. It is not authority at all.

D. Plaintiff is Not Entitled to the Remedy of its Choice

Plaintiff argues that preemption should not apply here because "it would leave plaintiff without a forum for its tort claims." (Pl. Br. at 31) The words are carefully chosen: plaintiff does not, and could not, say that preemption would leave it with no remedy for the alleged wrong it complains of – a "scheme" to file what plaintiff has called a "bad faith" bankruptcy and to "dodge" and "evade" protections given to creditors like plaintiff under the bankruptcy laws. As we have pointed out above, and as the Appellate Division observed, plaintiff had a remedy in Bankruptcy Court – moving to dismiss the allegedly abusive bankruptcy

proceedings. It made such a motion in Mezz Borrower's bankruptcy, but chose to withdraw it. It never moved to dismiss Mortgage Borrower's bankruptcy.

Plaintiff complains that preemption would leave it unable to sue defendants for damages. This is no doubt true, but it is irrelevant. It is not "relevant to an analysis of the scope of federal preemption that appellants may be left without a remedy." *Cromwell v. Equicor-Equitable HCA Corp.*, 944 F.2d 1272, 1276 (6th Cir. 1991). In *Phillips v. Amoco Oil Co.,* 799 F.2d 1464, 1470 (11th Cir. 1986), the court said:

> The employees protest that to hold that ERISA preempts this fraud claim, while also holding that ERISA does not prohibit the wrong the employees feel they have suffered, leaves a "gap" in the law. That is exactly the result that obtains when Congress determines that federal law should govern a broad area to the exclusion of state regulation and chooses not to prohibit actions formerly prohibited by state law. It is the very conflict between the federal scheme and state law that is to be avoided through preemption. To argue that Congress has created a "gap" in the law does not undermine the reasoning on which a finding of preemption is based.

See also Caterpillar v. Williams, 482 U.S. 386, 391 n.4 (1987) (claims could be removed to federal court even if only available remedy is in state court).

The remedies for abuse of the bankruptcy laws are to be decided by Congress, and Congress has not provided a damage remedy against third parties who facilitate bankruptcy filings – perhaps concluding, for the reasons we have discussed, that the harm done in chilling bankruptcy filings would outweigh the

benefit from allowing the recovery of damages. This is not a reason to reject preemption – it reinforces the point that the availability of a particular remedy for alleged misconduct in the institution of federal bankruptcy proceedings should depend on federal law.

In short, the law does not give plaintiff the remedy of its choice. That is not a barrier to federal preemption.

E. The Articles Plaintiff Relies on Provide No Valid Reason for Reversal

Plaintiff cites three articles that have discussed the Appellate Division's decision here – from the Commercial Observer ("CO"), from Law 360 and from a publication known as LexBlog.[5] Plaintiff says that these articles support its arguments that the Appellate Division's ruling will disrupt real estate lending and was wrong on the law. None of the articles gives any substantial support to either argument.

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[5] 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-courtdecision-could-upend-construction-financing-deals/); Janice MacAvoy, Matthew Parrott and Justin Santolli, Law360, Feb. 7, 2019, *Why NY's Sutton 58 Decision Won't Rattle RealEstate Finance*, https://www.law360.com/articles/1126535/why-ny-ssutton-58-decision-won-t-rattle-real-estate-finance); 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-turniptruck-yesterday-whats-at-stake-for-commercial-real-estate-lendersin-sutton-58/.

The CO article is the only one of the three to endorse plaintiff's claim that the Appellate Division decision puts real estate lending practices in jeopardy. But the article is, to put it bluntly, a suspect source. It was published shortly after the Appellate Division decision and reads as though it were written (as it perhaps was) to support plaintiff's motion for leave to appeal. The CO had previously published several articles featuring one of plaintiff's owners, Jonathan Kalikow, and other members of the Kalikow family in a favorable light. [6] Now, it published one with the title "*Latest Sutton 58 Court Decision Could 'Upend' Construction Financing Deals*". The article's authors based that conclusion wholly on anonymous quotes from people identified only as lawyers and developers. As to all of those sources, the article conspicuously failed to say (as such articles often do say) that the source was not involved in the case. For all that appears in the article, every person quoted in support of its thesis could have been a Kalikow lawyer, affiliate, or family member. As the LexBlog headline, quoting plaintiff's counsel's argument in the Appellate Division, put it: Nobody fell off the turnip truck yesterday.

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[6] Mack Burke and Cathy Cunningham, *Sutton Strike: Gamma's Jonathan Kalikow on the War Over 3 Sutton Place*, Commercial Observer (September 17, 2017), https://commercialobserver.com/2017/09/sutton-strike-gammas-jonathankalikow-on-the-war-over-3-sutton-place/; Greg Kalikow, *Talkin 'Bout My Generation,* https://commercialobserver.com/2018/05/talkin-bout-my-generation/; Cathy Cunningham, *Greg Kalikow Talks Family Pride and His Southeast Strategy*, https://commercialobserver.com/2018/03/greg-kalikow-talks-family-pride-and-his-southeast-strategy/.

As far as defendants know, the CO is the only real estate industry publication that has reacted in any way to the Appellate Division's decision in this case. Every other recognized industry publication has ignored it completely. This is not what one would expect if it were true, as plaintiff claims, that the decision "is likely to hamper real estate development in New York" (Pl. Br. at 2) and leave the creditor community defenseless against "unscrupulous venture capitalists" (*id.* at 3).

Neither the Law 360 nor the LexBlog article supports the idea that the Appellate Division decision will traumatize the industry. The Law 360 article flatly rejects that idea in its headline: "Why NY's Sutton 58 Decision *Won't* Rattle Real Estate Finance" (emphasis added). Plaintiff quotes alarmist language from the LexBlog article ("game-changing consequences", "could only have the impact of contracting real estate finance", quoted in Pl. Br. at 34 n.15), but the quotes are out of context. They are presented by the LexBlog authors as speculations about consequences that could flow not from this case but from unlikely, hypothetical rulings in future cases.

The Law 360 and LexBlog articles do criticize the Appellate Division decision, but their criticisms are cursory and, we submit, unpersuasive. The Law 360 authors say that the decision "is in apparent tension with" *Extended Stay* and that the two cases are "difficult to reconcile". This brief has explained why there is

no real "tension" between the Appellate Division decision and *Extended Stay* and why reconciling the cases is "difficult" only in the sense that the analysis is complicated – not that the conclusion is open to doubt. *See* pages 26-30 above. The LexBlog article offers neither reasoning nor authority to support its view that the Appellate Division decision was wrong.

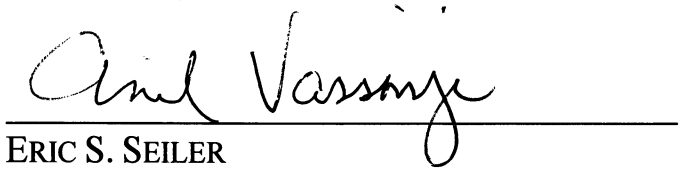
There is, however, one cogent comment in the LexBlog article: "We wish the plaintiffs [*sic*] in this case had pursued the bad faith filing issue in the bankruptcy proceedings, but for whatever reason, they did not." The LexBlog authors are correct, we submit, in thinking that plaintiff should have sought a remedy in Bankruptcy Court if its claims of abuse and injury were well-founded. Plaintiff chose instead to do an end run around the Bankruptcy Court with a state-court tort action. The Appellate Division correctly held that action to be preempted.

CONCLUSION

For the reasons stated above, the order of the Appellate Division should be affirmed.

Dated: September 25, 2019

Respectfully submitted,



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CERTIFICATE OF COMPLIANCE

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The foregoing brief was prepared on a computer. A proportionally spaced typeface was used, as follows:

Name of typeface: Times New Roman

Point size: 14

Line spacing: Double

The total number of words in the brief, inclusive of point headings and footnotes and exclusive of pages containing the table of contents, table of citations, proof of service, certificate of compliance, or any authorized addendum containing statutes, rules and regulations, etc. is 7,962 words.