APL-2019-00028
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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.

DEFENDANTS-RESPONDENTS' OPPOSITION TO BRIEF OF *AMICUS CURIAE* AMERICAN COLLEGE OF MORTGAGE ATTORNEYS

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CORPORATE DISCLOSURE STATEMENT

Pursuant to Rule 500.1(f) of the Rules of Practice of the Court of Appeals of the State of New York, Prime Alliance Group, Ltd. and Sutton Opportunity LLC state that neither has a parent company, subsidiaries, or affiliates, and that no publicly held corporation owns 10% or more of either of their stock.

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PRELIMINARY STATEMENT

The Brief for *Amicus Curiae* American College of Mortgage Attorneys ("ACMA") in Support of Plaintiff-Appellant ("Amicus Br.") makes essentially the same arguments, and rests on the same flawed assumptions, as the arguments made by plaintiff in this action. ACMA insists that the January 10, 2019 Decision and Order (the "Decision") of the Appellate Division First Department (the "Appellate Division") will harm commercial mortgage lenders in two ways. *First*, they face a "jurisdictional limbo" with no forum in which to sue non-debtors who harm them. *Second*, they will suffer higher risks and borrower costs, which will hurt secured real estate lending in New York State. ACMA is incorrect on both counts.

ACMA's first argument is based on a misunderstanding of the Decision. The Appellate Division did not prohibit commercial lenders from bringing *any* state law claim against third parties. It only held that state law claims that are based on a proceeding in bankruptcy, where the alleged harm is a bankruptcy filing, are preempted by federal bankruptcy law. Any dispute concerning the bankruptcy filing must be resolved by bankruptcy law. As defendants' brief (Brief for Defendants-Respondents ("Def. Br."), at 11-15) makes clear, this is standard federal preemption law.

As a result, there is no "jurisdictional limbo" (Amicus Br. at 1): plaintiff could (and indeed, has already attempted to) seek relief in the Bankruptcy Court itself. The relief available under bankruptcy law may not be the same as for a tortious interference claim under New York law, but that does not mean that plaintiff had nowhere to go if it was wronged. Federal preemption law does not entitle a plaintiff to the exact claim it wants to bring. If federal bankruptcy law does not offer the precise relief plaintiff prefers, that is a matter for Congress.

ACMA's misapprehension of the Decision also infects its argument that the Decision will harm commercial lenders. The Decision merely restates long-standing federal preemption doctrine. It has no effect on lenders who want to enforce contractual provisions against borrowers or guarantors—as plaintiff has already done in this case. And the Decision has no effect on lenders who want to enforce contractual provisions against third parties, as long as the claims do not arise out of a bankruptcy. Only lenders who want to sue a third party for helping a borrower breach covenants that restrict the borrower's access to bankruptcy are affected—and established law has barred such suits for many years. In short, the Decision will mean business as usual for commercial real estate in New York.

ARGUMENT

I.

COMMERCIAL LENDERS FACE NO JURISDICTIONAL LIMBO

ACMA's main argument is that commercial lenders will have nowhere to seek judicial relief when third parties provide the means for borrowers to breach loan covenants. This argument is flawed for several reasons. *First*, it relies on a mischaracterization of the Appellate Division's ruling, and mistakenly suggests that plaintiff's claims are wholly or partly independent of the bankruptcy proceedings. *Second*, the possibility that a Bankruptcy Court is unable to adjudicate the *specific claim* brought by a lender is irrelevant to whether the claim is preempted by federal law. *Third*, the "established caselaw" on which ACMA relies addresses a jurisdictional question that has nothing to do with preemption or with this case.

A. The Decision Applies Only to State Law Claims, Like Plaintiff's, That Are Dependent on Bankruptcy Proceedings

ACMA mistakenly describes plaintiff's claims as state law claims independent of any bankruptcy proceeding. According to ACMA, plaintiff sued defendants for their "allegedly tortious pre-bankruptcy actions" that helped the borrowers "breach certain covenants in the loan agreement between the lender and the borrower/debtor . . ." (Amicus Br. at 1.) Attempting to isolate the tort claims from the bankruptcy proceeding, ACMA argues that the Decision eliminates the one jurisdiction available to plaintiff, since bankruptcy courts are prohibited from issuing final decisions on purely state law claims. (*Id*. at 2.)

This is simply not what the Appellate Division said. As the pleadings make clear (R53-54), the Appellate Division recognized (Decision, at 1), and even ACMA concedes (*see* Amicus Br. at 1-2 n.1 ("Appellant asserted that the contract breaches at issue aided the borrower/debtor in the filing and conduct of its chapter 11 bankruptcy case and ultimately made it more difficult and expensive for the lender to exercise its contractual rights")), plaintiff's claims are inextricably tied to bankruptcy proceedings. The alleged wrongs were transactions that facilitated bankruptcy proceedings and the only alleged harm came from the delay caused by those proceedings, which, plaintiff claims, would have been avoided had the loan covenants successfully blocked the borrowers from entering bankruptcy. (R53-54.) Certain of the loan covenants in issue were specifically crafted to prevent the borrowers from filing for bankruptcy; others are involved in this case solely because they allegedly could have prevented the bankruptcy filings. The Decision, therefore, was narrowly focused on the claim that plaintiff makes: that defendants tortiously interfered with covenants that restricted the borrowers' ability to enter bankruptcy. Only that claim, and not a commercial lender's broad ability to enforce its loan agreement, is preempted by federal bankruptcy law.

B. Preemption Does Not Deny Plaintiff Any Remedy, Just the Specific State Law Claims It Asserts

ACMA makes the same mistake as plaintiff. (*See* Brief for Plaintiff-Appellant ("Pl. Br.") at 31-32, to which defendants responded in Def. Br. at 29-31.) Contrary to what both plaintiff and ACMA assert, federal preemption of plaintiff's specific tortious interference claim does not preclude plaintiff from seeking or obtaining *any* relief for the wrongs it allegedly has suffered. To the contrary, plaintiff had many remedies available to it; it just failed to avail itself of all of them. ACMA's attempt to paint plaintiff as a victim with no recourse is misguided.

Indeed, plaintiff has already sought and received relief for the borrowers' default on its loans. In the loan agreements, plaintiff obtained a guarantee from the principals of the Mezzanine Borrower (Joseph Beninati, Christopher Jones, and Daniel Lee), for the full amount of the loan. (R52-53; Affidavit of Jonathan Kalikow, Ex. B at §2(a), *Sutton 58 Assocs. LLC v. Beninati et al.*, No. 651296/16 (N.Y. Sup. Ct. Mar. 10, 2016), Dkt. No. 5.) By filing a voluntary bankruptcy, the Mezzanine and Mortgage Borrowers triggered the principals' guarantee. Plaintiff has already recovered a judgment of over $24 million against Messrs. Beninati, Jones, and Lee. (R52-53; Judgment at 2, *Sutton 58 Assocs. LLC v. Beninati et al.*, No. 651296/16 (N.Y. Sup. Ct. Jan. 12, 2017), Dkt. No. 82.) This was exactly the recourse plaintiff bargained for.

Plaintiff had plenty of other recourse. A commercial mortgage lender like plaintiff who claims injury because the borrower improperly filed for bankruptcy can seek relief for a frivolous bankruptcy filing. *See Gonzales v. Parks*, 830 F.2d 1033, 1035 (9th Cir. 1987) ("remedies have been made available in the federal courts to creditors who believe that a filing is frivolous.") Aggrieved creditors can also seek dismissal of frivolous or bad faith bankruptcy filings. *See In re Thirtieth Place, Inc.,* 30 B.R. 503, 505 (Bankr. App. 9th Cir.1983) (dismissing bankruptcy petition as filed in bad faith, noting that "[a] petition filed in bad faith may manifest an intent to cause hardship or to delay creditors by resort to the Chapter 11 device merely for the purpose of invoking the automatic stay," such as "[t]he transfer of one's assets to a new debtor on the eve of a Chapter 11 filing"); *In re C-TC 9th Ave. Partnership,* 113 F.3d 1304, 1311-12 (2d Cir. 1997) (affirming dismissal of bankruptcy petition where petitioner was a single-asset entity and was the subject of a foreclosure action, and "the timing of [its] filing evidence[d] an intent to delay and frustrate the legitimate efforts of [the main creditor] to enforce its rights"). Indeed, plaintiff here *already attempted* to dismiss one of the bankruptcy filings before changing its mind. (*See* Decision at 1-2.) Sanctions are also available. *In re 2218 Bluebird Ltd. Partnership,* 41 B.R. 540, 542–43, 46 (Bankr. S.D. Cal. 1984) (finding debtor, who facilitated transfer of property to "invoke the protection of the automatic stay without an intent to reorganize," acted in bad faith and awarding sanctions "to compensate for the actual injuries suffered by a private party").

As the Ninth Circuit has explained:

> Congress' authorization of certain sanctions for the filing of frivolous bankruptcy petitions should be read as an implicit rejection of other penalties, including the kind of substantial damage awards that might be available in state court tort suits. Even the mere possibility of being sued in tort in state court could in some instances deter persons from exercising their rights in bankruptcy. In any event, it is for Congress and the federal courts, not the state courts, to decide what incentives and penalties are appropriate for use in connection with the bankruptcy process and when those incentives or penalties shall be utilized.

Gonzales, 830 F.2d at 1036. *See also Pertuso v. Ford Motor Credit Co.*, 233 F.3d 417, 425-26 (6th Cir. 2000) ("It is very unlikely that Congress intended to permit the superimposition of state remedies on the many activities that might be undertaken in the management of the bankruptcy process . . . Permitting assertion of a host of state law causes of action to redress wrongs under the Bankruptcy Code would undermine the uniformity the Code endeavors to preserve and would stand as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress.") (internal citations omitted).

Thus, ACMA's position that "reversal of the Decision is essential in order to maintain access to the judicial system for mortgage lenders in commercial real estate transactions in New York" (Amicus Br. at 2) is mistaken. Lenders like plaintiff have considerable access to the judicial system, which the Decision leaves untouched.

C. <u>The *Stern* Doctrine Is Irrelevant to the Preemption Issue</u>

ACMA relies on unrelated Supreme Court doctrine to bolster its contention that plaintiff has no available forum for its claims, and therefore preemption is improper. It is true that, under the trilogy of cases on which ACMA relies (Amicus Br. at 3-4), federal Bankruptcy Courts cannot finally adjudicate state-law claims against non-debtors. But it simply does not follow that such claims cannot be preempted by federal law. And the cases ACMA cites say nothing about whether any of plaintiff's other potential remedies are available—which, as explained above, they certainly are. ACMA, like plaintiff, simply refuses to acknowledge that plaintiff is not entitled to the specific remedy it wants. When federal law preempts a state law claim, a would-be plaintiff must look to federal law.

ACMA provides a lengthy explanation of the *Stern* doctrine, which is a set of Supreme Court decisions that clarify when bankruptcy courts can issue final resolutions of state law claims. (Amicus Br. 3-6.) *See Stern v. Marshall*, 564 U.S. 462 (2011); *Executive Benefits Ins. Agency v. Arkison*, 573 U.S. 25 (2014); *Wellness Int'l Network, Ltd. v. Sharif*, 575 U.S. 1932 (2015). These cases, ACMA correctly says, "establish[] that a state-law-based cause of action asserted by a debtor against a non-debtor party, where the non-debtor party has not submitted to the jurisdiction of the bankruptcy court, cannot be finally adjudicated in a bankruptcy court without the consent of the non-debtor party." (Amicus Br. at 4 (emphasis omitted).) That plaintiff could not bring its specific state-law claims in a Bankruptcy Court is not in dispute. But it remains true, as the Appellate Division held, that those state-law claims are preempted by federal law, and that plaintiff must pursue whatever relief Congress provided under federal bankruptcy law.

None of the *Stern* cases even discusses federal preemption. And a decision of the Federal Circuit Court of Appeals confirms that *Stern* has no impact on federal preemption doctrine. In *Milik v. Sec'y of Health & Human Servs.*, 822 F.3d 1367, 1371 (Fed. Cir. 2016), a family sought compensation under for the disabilities of their son. A federal statute, the Vaccine Act, required the family to litigate their claims before a special master, and only permitted review by an Article III judge for an abuse of discretion. *Id*. at 1374-76. The family argued that, under *Stern*, Congress could not remove access to Article III courts for common law claims, and that the Vaccine Act unconstitutionally denied them access not only to federal courts but also to "the common law protections afforded in state courts for tortious injuries against the manufacturers of vaccines." *Id*. at 1376-77. The Federal Circuit disagreed, observing that Congress could preempt state law claims and provide the means for asserting federal claims of its choosing, and held that *Stern* was inapplicable. "There is no doubt Congress has the authority under the Supremacy Clause to preempt state law causes of action which conflict with the federal standards and policies set forth in a duly authorized federal statute . . . Stern *simply does not address the preemption of state law claims*; it only addresses who may decide claims that are not otherwise preempted." *Id*. at 1378 (emphasis added).

ACMA argues that the "Decision makes an exponential leap beyond the *Stern* trilogy . . . and extends exclusive bankruptcy court jurisdiction to a claim that is strictly between two non-debtor parties." (Amicus Br. at 4 (emphasis omitted).) But the Decision does nothing of the kind. It says not a word about "exclusive bankruptcy court jurisdiction." It says that plaintiff's state law claim of tortious interference is preempted by federal bankruptcy law.

It is likely true that, as plaintiff and ACMA say, there is no forum anywhere for plaintiff's tortious interference claim. That is what federal preemption means. Congress can choose to provide its own remedy for a wrongful act—in this case, assisting a debtor with an allegedly frivolous bankruptcy filing designed to thwart creditors—or it can choose to provide no remedy whatsoever. Here, the bankruptcy laws do offer remedies, such as dismissal of the petition or sanctions, and these are all the remedies plaintiff had.

II.

FEDERAL PREEMPTION DOES NOT AFFECT LENDER RISK OR BORROWER COST

ACMA argues that if lenders like plaintiff are unable to litigate tortious interference claims like this one to enforce the contractual provisions in their loan agreements, lenders will suffer harm. (Amicus Br. at 7-8.) There is no basis for this argument. The Decision leaves the well-established balance between the rights of debtors and creditors undisturbed.

First, ACMA misstates the scope of the Decision. Defendants do not argue, and the Appellate Division did not hold, that lenders cannot enforce "commonly negotiated contractual rights" to the extent that those contractual rights do not interfere with federal bankruptcy proceedings. (Amicus Br. at 7-8.) In such cases, federal bankruptcy law is not implicated, and lenders are free to pursue tortious interference claims or any other valid claims in state court.

But the loan covenants sued upon in this case *were* tied to bankruptcy. Indeed, ACMA concedes that one of the provisions in plaintiff's loan agreement was designed to assure the borrower would remain a "single asset real estate debtor"—a concept significant only in a bankruptcy context. (Amicus Br. at 9.) And ACMA underscores the point by citing an article about "Bankruptcy Remote Entities in Commercial Real Estate Transactions." (Amicus Br. at 9, n.2.) As invoked in this case, the loan covenants in issue could serve only one purpose: to keep the borrowers away from bankruptcy.

Of course, this is not surprising. All lenders (and their attorneys, including the mortgage attorneys who make up ACMA's membership) want to keep their borrowers out of bankruptcy, and loan covenants are often designed or invoked for that purpose. But debtors have a federally protected right to seek bankruptcy proceedings, and the extent to which claims based on loan covenants or other claims under state law can properly interfere with that right is a question of federal law. A large number of federal and state cases—discussed in Defendants' Brief at 15-24, but completely ignored in ACMA's brief—establish the governing principle: "No 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 (2002) (emphasis omitted). The Decision is a straightforward application of this principle, and does not shift the balance between lenders and borrowers at all.

Second, over a year has passed since the Appellate Division issued its Decision. But contrary to ACMA's and plaintiff's predictions of doom for the commercial lending industry (*see* Pl. Br. at 2-3; Amicus Br. at 7-8), commercial lending has continued unabated. Neither ACMA nor plaintiff has offered any evidence of new prohibitive lending costs, reduced "availability of secured mortgage credit to owners and developers," or any outcry about "increase[d] . . . risk to real estate lenders in New York." (Amicus Br. at 8.) The commercial real estate industry has shrugged and gone about its business as before. A recent comment on this case by a leading real estate lawyer confirms this: "If the courts deny the lender the relief it seeks, will that derail commercial real estate lending? No. . . . [I]f the courts decide the lender has no claim against Pilevsky, that in no way jeopardizes ordinary single-purpose entity covenants, nonrecourse carveout guaranties, or the structure and viability of commercial real estate financing." Joshua Stein, Does a Creative Bankruptcy Scheme Imperil Commercial Real Estate Lending?, Fall 2019 eReport, Real Property, Trust and Estate Law, American Bar Association, Dec. 9, 2019, at 2-3.

ACMA also argues that the Decision could be applied to third party guarantees in commercial real estate contracts. ACMA contends that the Decision allows guarantors to "argue that . . . [an] enforcement action on the guaranty must be relegated to the same legal limbo created for the" tortious interference claims. (Amicus Br. at 12.) But this is simply incorrect. Nothing in the Decision, or in the many other decisions applying the *Astor-Choy* rule, has any impact on contract claims by lenders against guarantors. The rule is expressly limited to "tort" claims.

Contrary to ACMA's protestations, commercial lenders have the same set of tools to enforce their loan covenants that they always have had. As plaintiff did in this case, commercial lenders can seek relief against the borrower, enforce third party guarantees, and seek relief from wrongful or bad faith bankruptcy filings. The Appellate Division's ruling merely reiterates what many other courts have held: state-law tort claims based on bankruptcy filings are preempted by federal law.

CONCLUSION

For the reasons stated herein, and in Defendants' Brief, the arguments made by ACMA should be rejected and the Appellate Division's decision should be affirmed.

Dated: January 13, 2020.

Respectfully submitted,

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CERTIFICATE OF COMPLIANCE

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