SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK - PART 60

----------x
LEHMAN BROTHERS HOLDINGS INC.,

Index No. 652178/2012

Plaintiff,

- against -

DECISION AND ORDER

IVC WH HG II, LLC,

Defendant.
----------x

FRIEDMAN, J.

This is an action by plaintiff Lehman Brothers Holdings Inc. (LBHI), the holder of a junior participation interest in a junior mezzanine loan to a hotel real estate venture, against defendant IVC WH HG II, LLC (IVC), the holder of the senior participation interest in that loan. LBHI seeks to enforce contractual ownership rights assertedly arising upon a foreclosure on the collateral for the junior mezzanine loan. LBHI moves for summary judgment declaring that IVC is required to establish a Delaware limited liability company to hold equity interests to which IVC took title, allegedly on behalf of both LBHI and IVC, as a result of the foreclosure. IVC moves for summary judgment declaring that it took title to the equity interests solely on its own behalf, and that the complaint should be dismissed. For the reasons stated below, both motions are denied.

Background

The following facts regarding the loan transaction are undisputed. In June 2006, LBHI originated financing for the purchase of a group of hotels by two entities, including a Goldman Sachs subsidiary. (Joint Statement of Undisputed Facts, ¶ 6 [Joint Statement].) The financing

was structured in tiers, which included a $160 million mortgage loan (the Mortgage Loan) to the mortgage borrower, W2005 WYN Hotels, L.P. (the Mortgage Borrower). The Mortgage Loan was secured by collateral including a first priority fee or leasehold mortgage encumbering the Mortgage Borrower's interest in each of the individual hotels. (Id., ¶¶ 7-8.)

The financing also included two separate mezzanine loans. The first and senior mezzanine loan (the Senior Mezzanine Loan) was made to W2005 WYN Senior Mezz, L.L.C. (the Senior Mezzanine Borrower). The second and junior mezzanine loan (the Junior Mezzanine Loan) was made to W2005 WYN Junior Mezz, L.L.C. (the Junior Mezzanine Borrower) (together, the Mezzanine Loans). Each mezzanine loan was in the original principal amount of $62,500,000, and had its own collateral. (Id., ¶ 7.) The Senior Mezzanine Borrower pledged all of its interests in the Mortgage Borrower, W2005 WYN Hotels, L.P., as collateral for the Senior Mezzanine Loan. The Junior Mezzanine Borrower pledged all of its interest in the Senior Mezzanine Borrower as collateral for the Junior Mezzanine Loan. (Id., ¶¶ 9-10.) "Specifically, the Junior Mezzanine Loan was secured by a 100% interest in the Senior Mezzanine Borrower (the 'Equity Interests')." (Id., ¶ 10.)

In June 2008, LBHI sold the Mezzanine Loans to two entities: IVC WH HG I LLC (IVC I) became the lender and holder of the Senior Mezzanine Loan, and defendant IVC became the lender and holder of the Junior Mezzanine Loan. (Id., ¶ 12 & n 10-11.) At the time of the sale, the principal balance of the Mortgage Loan was $108,429,710, and the principal balances of the Senior and Junior Mezzanine Loans were $52,232,264 and $38,792,099, respectively. (Id., ¶ 16.) LBHI sold the Mezzanine Loans to the IVC entities for 82.5% of their par value, for a total of $65,195,099. (Id., ¶¶ 13, 18.)

In connection with the sale of the two Mezzanine Loans, LBHI obtained from IVC a Junior Participation Interest in the Junior Mezzanine Loan, with a principal balance of $12,000,000 of the total $38,792,099 principal balance of this Loan. IVC held the Senior Participation Interest in the remaining $26,792,099 balance of the Junior Mezzanine Loan. (Id., ¶ 17.) The parties' Participation Interests are governed by a Participation Agreement executed on or about June 4, 2008 (Participation Agreement or Agreement), under which LBHI's Junior Participation Interest was subordinated to IVC's Senior Participation Interest. (Id., ¶¶ 17, 21.)[1]

Also in connection with the sale, a different Lehman entity, Lehman Commercial Paper Inc. (LCPI), provided seller financing of $39,117,059 to the IVC entities, representing 60% of the total purchase price for the Loans (Seller Financing). (Id., ¶ 19.)

Three months after the loan transaction, on September 15, 2008, LBHI declared bankruptcy. (Id., ¶ 26.)

The Mortgage Loan, Senior Mezzanine Loan, Junior Mezzanine Loan, and Seller Financing had a maturity date of August 9, 2011. (Id., ¶ 20.) On the maturity date, the Junior Mezzanine Borrower failed to repay the Junior Mezzanine Loan. That failure constituted an Event of Default for purposes of the Participation Agreement. (Id., ¶ 32.) On August 10, 2011, IVC sent a letter to Lehman advising of the occurrence of the default. (Id., ¶ 33.) On August 10, 2011, in connection with the Seller Financing, LCPI made an offer to purchase the IVC entities' interest in the Mezzanine Loans for a price equal to $65,195,099. (Id., ¶ 34.) This offer was

[1] The parties executed several other agreements in connection with the loan transaction. These included: an Intercreditor Agreement, dated August 1, 2007, executed by Lehman in its capacities as the mortgage lender, the Senior Mezzanine Lender, and the Junior Mezzanine Lender, which governed the relationships among these lenders (Joint Statement, ¶ 12); and an Assignment and Assumption Agreement, dated as of June 4, 2008, by which LBHI assigned to IVC all of its right, title, and interest in the Junior Mezzanine Loan that LBHI had made to the Junior Mezzanine Borrower.

It is undisputed that the Participation Agreement is the only agreement that governs the parties' claims on these motions.

rejected and, on or about August 10, 2011, IVC and IVC I repaid the Seller Financing to LCPI. (Id., ¶¶ 34-35.)

IVC then initiated a foreclosure proceeding on the Junior Mezzanine Loan. (Id., ¶ 38.) On August 19, 2011, IVC published a Notice of Public Sale of Collateral in the Wall Street Journal. (Id., ¶ 39.) On August 22, 2011, "IVC, as the 'Secured Party,' conducted a Uniform Commercial Code foreclosure sale (a public auction) of the collateral for the Junior Mezzanine Loan." (Id., ¶ 40.) IVC was the sole and successful bidder at the auction, and "took title to the Equity Interests (i.e., the membership interests in W2005 WYN Senior Mezz, L.L.C.) through a credit bid." (Id. ¶¶ 43-45.)

Discussion

In moving for summary judgment, LBHI contends that under section 10 of the Participation Agreement, which governs the parties' contractual relationship, IVC was required, in the event it foreclosed on the collateral (i.e., the Equity Interests) for the Junior Mezzanine Loan, to establish a Delaware limited liability company to hold those Equity Interests on behalf of both LBHI and IVC, on the same terms that governed their Participation Interests prior to the foreclosure. (Pl.'s Memo. In Supp. of Pl.'s Motion at 1-4 [Pl.'s Memo. In Supp.].)[2] In opposition, and in support of its own motion, IVC contends that it took title to the Equity Interests on its own behalf, and that section 10 of the Participation Agreement merely provided that "if IVC were to take title to the Junior Mezzanine Loan collateral on behalf of both participants, the parties would form an LLC to hold those interests together." (Def.'s Memo. In

[2] LBHI held a 30.9241% Percentage Interest, and IVC held a 69.0759% Percentage Interest, as defined in the Participation Agreement.

Supp. of Def.'s Motion at 3 [Def.'s Memo. In Supp.].) IVC further contends that under the Participation Agreement, LBHI "would not be entitled to any recovery unless the proceeds of the sale of the collateral exceeded the $26 million face value of IVC's senior participation interest" (id. at 2), and that LBHI was not in fact entitled to any recovery because IVC's bid was substantially less than the amount of the outstanding principal balance of its senior participation interest. (Id. at 4.)

The parties' dispute over whether IVC was required to form an Owning Entity has significant economic ramifications, as it is undisputed that the hotels remaining in the underlying hotel portfolio were valued as of mid-2014 at between $210,000,000 and $230,000,000. (Joint Statement, ¶ 57.)

Section 10 of the Participation Agreement provides in full:

> "In the event that the Senior Participant, acting on behalf of the Participants, shall take title to the Equity Interests or the Property, whether through an Enforcement Action or by conveyance in lieu thereof or otherwise, then, subject to the requirements of the Intercreditor Agreement, the Participants shall establish a Delaware limited liability company to be the Owning Entity and to hold the Equity Interests or the Property, as applicable. The Participants shall be the owners of the Owning Entity with the same economic interests as provided in this Agreement, and with the Junior Participation Interest being subordinate to the Senior Participation Interest as provided in this Agreement. The terms and conditions of the operating agreement for the Owning Entity shall be substantially on the same terms as this Agreement and otherwise mutually satisfactory to the Participants; provided, however, that neither any failure to agree on the terms of such an operating agreement nor any failure of the Owning Entity to constitute a Qualified Transferee or otherwise comply with the Intercreditor Agreement shall in [sic] interfere with Senior Participant's ability to take title to the Equity Interests or the Property in its own name or through a designee on behalf of the Participants."

LBHI and IVC agree that section 10 is unambiguous. (Pl.'s Memo. In Supp. at 10; Def.'s Memo. In Supp. at 10.) They also agree that section 5 of the Participation Agreement delegates to IVC, as the Senior Participant, "the sole and exclusive authority . . . with respect to the administration and enforcement of, and exercise of rights and remedies with respect to, the Mezzanine Loan, including, without limitation, the sole authority to . . . institute any foreclosure action or other remedy. . . ." LBHI thus acknowledges that "LBHI ceded control to IVC under the Participation Agreement." (Pl.'s Reply Memo. In Further Supp. at 5 [Pl.'s Reply Memo.]; Def.'s Memo. In Opp. to Pl.'s Motion at 5.) They dispute, however, whether section 10 required IVC, under the circumstances at issue, to foreclose upon both Participants' behalf, or whether it permitted IVC to foreclose solely on its own behalf. (See Def.'s Memo. In Supp. at 10-11.) The parties' dispute thus presents an issue of contract interpretation.

Under New York law, it is well settled that "written agreements are construed in accordance with the parties' intent and the best evidence of what parties to a written agreement intend is what they say in their writing." (Schron v Troutman Sanders LLP, 20 NY3d 430, 436 [2013] [internal quotation marks, brackets, and citation omitted].) Thus, "when parties set down their agreement in a clear, complete document, their writing should as a rule be enforced according to its terms. Evidence outside the four corners of the document as to what was really intended but unstated or misstated is generally inadmissible to add to or vary the writing." (W.W.W. Assocs., Inc. v Giancontieri, 77 NY2d 157, 162 [1990]; accord Vermont Teddy Bear Co. v 538 Madison Realty Co., 1 NY3d 470, 475 [2004].) The court should determine from contractual language, without regard to extrinsic evidence, whether there is any ambiguity. (Chimart Assocs. v Paul, 66 NY2d 570, 573 [1986].) "Ambiguity in a contract arises when the

contract, read as a whole, fails to disclose its purpose and the parties' intent, or where its terms are subject to more than one reasonable interpretation." (Universal Am. Corp. v Natl. Union Fire Ins. Co. of Pittsburgh, Pa., 25 NY3d 675, 680 [2015] [internal quotation marks and citation omitted].)

A court presented with a contractual interpretation issue should "construe the [contract] so as to give full meaning and effect to the material provisions. A reading of the contract should not render any portion meaningless. Further, a contract should be read as a whole, and every part will be interpreted with reference to the whole; and if possible it will be so interpreted as to give effect to its general purpose." (Beal Sav. Bank v Sommer, 8 NY3d 318, 324-25 [2007] [internal quotation marks and citations omitted]; W.W.W. Assocs., 77 NY2d at 162.) "All parts of an agreement are to be reconciled, if possible, in order to avoid inconsistency." (National Conversion Corp. v Cedar Bldg. Corp., 23 NY2d 621, 625 [1969].)

Applying these precepts, the court finds that the qualifying phrase in section 10 – "acting on behalf of the Participants" – may reasonably be read as defining the capacity in which IVC as the foreclosing party would be required to act in order for IVC's obligation to form an Owning Entity to arise and, thus, as establishing a condition to this obligation, separate from and in addition to the taking of title to the Equity Interests. Put another way, "in the event" is one of a number of phrases that may be used to introduce a condition precedent. (See Ginett v Computer Task Group, Inc., 962 F2d 1085, 1100 [2d Cir 1992].) In section 10, this phrase may reasonably be read as limiting the obligation to form the Owning Entity to circumstances under which the Senior Participant takes the Equity Interests on behalf of both Participants; but the phrase does

not exclude the possibility (or "event") that the Senior Participant may act on its own behalf.[3]

Although the punctuation and grammatical arrangement of the clauses in a contractual provision may aid a court in construing a contract (see 22 NY Jur 2d Contracts § 241), the court does not find here that the wording of section 10 of the Participation Agreement unambiguously supports either party's position as to whether IVC was required to act on behalf of both parties in foreclosing on the Junior Mezzanine Loan collateral and taking title to the Equity Interests.

More important, under the principles of contract interpretation discussed above, section 10 must be read in the context of the Participation Agreement as a whole. In fact, both parties rely on other provisions of the Agreement to support their respective positions as to the proper construction of section 10 and, in particular, as to whether IVC was required to foreclose on behalf of both Participants.

LBHI relies on section 5 (c), citing the sentence in that section that "[t]he Senior Participant shall, at all times, retain legal title to the Mezzanine Loan and be the secured party of record for each of the Senior Participation [IVC] and the Junior Participation [LBHI]." (See Pl.'s Reply Memo. at 3 [emphasis LBHI's].) LBHI then argues that "when IVC foreclosed on the Equity Interests during the Enforcement Action, it was, by definition, acting on behalf of the Participants." (Id. at 11 [emphasis LBHI's].) Reasoning that only a secured creditor can make a credit bid, that IVC credit bid in the foreclosure proceeding, and that IVC was the secured party for both the Senior and the Junior Participants, LBHI concludes that IVC must have foreclosed

[3] LBHI argues that if the parties had intended to permit IVC to take title on its own behalf, they would have had to add the words "if" or "when" to the phrase "acting on behalf of the Participants" in the first sentence of section 10. (Pl.'s Reply Memo at 12-13 [emphasis LBHI's].) If the parties had, however, intended that the obligation to form the Owning Entity be triggered upon IVC's acquisition of the Equity Interests, without more, they could have provided for the formation of the Owning Entity "[i]n the event that the Senior Participant shall take title to the Equity Interests." The court notes further that the use of the phrase "on behalf of the Participants" in the last sentence of section 10 does not eliminate the ambiguity as to the meaning of the phrase.

on behalf of both Participants. (Id.)

IVC, in contrast, relies on the provisions of the Participation Agreement that subordinate LBHI's interest to IVC's. IVC thus cites section 4 (d), the waterfall provision, which governs the payment of Distributable Funds if, as here, an Event of Default has occurred, and which provides for IVC to receive payment in full of its Senior Participant principal balance and accrued interest before any distribution to LBHI as Junior Participant. (Def.' s Memo. In Supp. at 11.) IVC also emphasizes the subordination provision of the Agreement, section 2 (d), which expressly provides: "The Junior Participation Interest and the right of the Junior Participant to receive payments of interest, principal and other amounts . . . shall at all times be junior, subject and subordinate to the Senior Participation Interest. . . ." (Def.'s Memo. In Supp. at 14.) Further, IVC cites section 5 (a) of the Agreement, the administration provision, which delegates to IVC "sole and exclusive authority . . . with respect to the administration and enforcement of . . . the Mezzanine Loan," and provides: "Unless an Event of Default shall have occurred and be continuing, subject to the terms of this Agreement, the Senior Participant shall not do anything that would disproportionately and adversely affect the Junior Participation Interest." (Def.'s Memo. In Supp. at 15 [emphasis IVC's].)

IVC also points to the workout provision, section 5 (d), which gives IVC the authority to make compromises with the Mezzanine Borrower, with the Junior Participant "to bear the full effect of all waivers, reductions or deferrals of amounts due on the Mezzanine Loan attributable to such Workout. . . ." (Def.'s Motion In Supp. at 16.) Finally, IVC appears to contend that the above provisions permit IVC to "wipe out LBHI's interest," but that the Participation Agreement does afford LBHI the opportunity preserve its interest by investing additional monies. (Id. at 17-

19, citing e.g. Participation Agreement section 6 [b] [permitting LBHI to make "Protective Advances" during an Event of Default to acquire a junior interest in the Senior Mezzanine or Mortgage Loan, if IVC purchases such Loan]; section 9 [permitting LBHI to make "Cure Payments" to forestall default by the Junior Mezzanine Borrower for up to six months]; section 21 [reallocation provision, permitting LBHI to request that IVC transfer its Senior Participation Interest to its Senior Mezzanine Loan and to transfer ownership of the remaining Junior Mezzanine Loan to LBHI].)

LBHI does not dispute that its interest was subordinated to that of IVC. On the contrary, LBHI stipulated that "[t]he Participation Agreement was generally one-sided in favor of the Senior Participant, IVC." (Joint Statement, ¶ 22.) LBHI specifically acknowledges that it "had very few rights under the Participation Agreement." (Pl.'s Memo. In Opp. to Def.'s Motion at 3.) But it asserts that IVC's obligations to LBHI "were limited, but they were not nonexistent" (id. at 15), and that "Section 10 contained one of the few rights LBHI did have." (Id. at 3.) LBHI also counters that its rights to make advances or to purchase IVC's interest did not relieve IVC of its obligations under section 10. (Id. at 17.) Further, LBHI argues that because IVC made a credit, rather than a cash, bid at the foreclosure sale, there were no Distributable Funds to be distributed through the section 4 (d) waterfall. (Id. at 18.)

Neither party demonstrates that the Participation Agreement, read as a whole, unambiguously either precluded or permitted IVC's foreclosure on the Junior Mezzanine Loan collateral solely on its own behalf. The Participation Agreement does not contain any section that by its terms provided for foreclosure by IVC solely on its own behalf. Moreover, section 10 contemplated, at a minimum, that there would be circumstances in which IVC foreclosed on

behalf of both itself and LBHI. In addition, the definition of Distributable Funds included all Payments, Prepayments and all other sums "received from time to time by Senior Participant on account of the Mezzanine Loan on behalf of the Participants (including, without limitation, amounts realized upon an Enforcement Action[4] or a transfer in lieu thereof, or by means of ownership or operation of the Equity Interests, the Property and/or Mezzanine Borrower . . . , to the extent received from time to time by Senior Participant on account of the Mezzanine Loan on behalf of the Participants)." This definition thus also contemplated that there would be circumstances in which the foreclosure would occur on behalf of both IVC and LBHI.

If there were no circumstance in which section 10 would apply to require the formation of an Owning Entity to hold Equity Interests foreclosed upon on behalf of both Participants, section 10 would be rendered meaningless. IVC does not in fact contend that it may always foreclose on its own behalf. In briefing and arguing the motions, however, IVC identified only one example of a circumstance in which IVC would undertake a foreclosure action on behalf of both itself and LBHI, and therefore in which the section 10 Owning Entity requirement would apply. IVC thus cited a negotiation in April 2011 between IVC and LCPI to extend the Seller Financing to IVC, and contended that if an agreement had been reached, the contemplated foreclosure "would presumably have been on behalf of both participants." (Def.'s Reply Memo. in Further Supp. at 10 [Def.'s Reply Memo.], citing Chattoraj Aff. Ex. 33 [email, dated April 25, 2011, from Christopher Hoeffel of Investcorp International Inc. to Michael Lascher and Susanne Frey of LBHI's subsidiary, stating in pertinent part: "In short, the proposal [by IVC] contemplates a potential foreclosure by the mezzanine lender on some or all [of] the mezzanine

[4] It is undisputed that the foreclosure action at issue was an Enforcement Action.

loan collateral, after which the acquisition loan would be secured by a combination of direct ownership equity and mezzanine borrower equity"]; Oral Argument Transcript at 23-27 [in response to this court's question, "when would Section 10 become operative?," IVC responded with the sole "example" that if the parties had reached an agreement to renegotiate the Seller Financing with LCPI, LBHI's Junior Participation Interest would have been preserved, and that would be "a circumstance where the Senior Participant says we are going to foreclose together . . ."].)[5] Notably, IVC did not point to any provision in the Participation Agreement that would have limited a foreclosure on behalf of LBHI to such a circumstance, or provided for such a foreclosure in that circumstance.

Contrary to IVC's contention, this court's interpretation of the Participation Agreement is not controlled by the cases cited by IVC for the proposition that the courts have consistently interpreted participation agreements to permit senior participants to protect their own superior interests, and to impose no obligation to protect junior participants' interests in the event of default. (Def.'s Memo. In Supp. at 22.) These cases (e.g. Lowenfeld v Wimpie, 139 AD 617 [1st Dept 1910], affd on opinion below, 203 NY 646 [1911]; Metro Inv. Serv., Inc. v President and Directors of Manhattan Co., 292 NY 463 [1944]) did not involve contractual provisions like section 10.

Nor does IVC demonstrate that its disposition of the collateral was consistent with the Uniform Commercial Code, as IVC does not cite any authority applying the statute. (See Def.'s Memo. In Supp. at 21-22 [citing, without discussing, UCC 9-608 (a) (1)].)

---

[5] IVC also acknowledged that by its express terms, section 10 also applies to a conveyance in lieu of foreclosure. (Def.'s Reply Memo. at 10.)

Finally, having concluded that the Participation Agreement is ambiguous as to whether section 10 required IVC to foreclose on the Junior Mezzanine collateral on behalf of both Participants, the court further holds that this ambiguity is not resolved by the extrinsic evidence submitted on these motions.

As discussed above, a court ordinarily may not consider extrinsic evidence in construing a contract, unless the court finds the contract ambiguous. In applying New York law, the Second Circuit Court of Appeals has held that evidence as to "custom and usage" in a particular trade or business is, however, "to be considered by the court where necessary to understand the context in which the parties have used terms that are specialized." (Law Debenture Trust Co. of New York v Maverick Tube Corp., 595 F3d 458, 466 [2d Cir 2010].) Put another way, "evidence as to custom and usage is considered, as needed, to show what the parties' specialized language is fairly presumed to have meant." (Id. at 466-467 [internal quotation marks and citation omitted].) In elucidating New York law, the Second Circuit relied on the reasoning of the New York Court of Appeals that where the parties to a contract have employed "[t]erms in common use in a business or art" that "may be understood by those engaged in the business or art . . . but which convey no meaning to those who are not initiated into the mysteries of the craft," the court "must be informed of the meaning of the language as generally understood in that business, in the light of the customs and practices of the business. It must be made literate in a language in which it is now unschooled." (Fox Film Corp. v Springer, 273 NY 434, 436-437 [1937] [quoted in Law Debenture Trust Co., 595 F3d at 466.)

Significantly, "[p]roof of custom and usage does not mean proof of the parties' subjective intent . . . . Rather, proof of custom and usage consists of proof that the language in question is

fixed and invariable in the industry in question." (Law Debenture Trust Co., 595 F3d at 466 [internal citations and quotation marks omitted].) Thus, summary judgment may not be granted based on extrinsic evidence as to industry custom and usage concerning the meaning of a term, unless (1) the custom and usage "is of such a definitive nature as to establish, as a matter of law, the meaning of that term to the industry; (2) it has been shown either that the parties are actually aware of the established usage of the term, or that 'the usage in the business to which the transaction relates is so notorious that a person of ordinary prudence in the exercise of reasonable care would be aware of it'; and (3) there is no question that the intention of the parties was to follow, rather than depart from, the industry custom at issue." (J.P. Morgan Inv. Mgt. Inc. v AmCash Group, LLC, 106 AD3d 559, 559-560 [1st Dept 2013], quoting Matter of Reuters Ltd. v Dow Jones Telerate, Inc., 231 AD2d 337, 343 [1st Dept 1997] [other internal citations omitted]; Last Time Beverage Corp. v F&V Distrib. Co., LLC, 98 AD3d 947, 951-952 [2d Dept 2012].)[6]

Here, although LBHI and IVC contend that the Participation Agreement is unambiguous, they both in fact rely extensively on extrinsic evidence. The extrinsic evidence that they submit does not, however, demonstrate established usage of specialized terms in the commercial real estate finance industry. LBHI and IVC offer expert reports from Joshua Stein and Leonard Cotton, respectively, both of whom have substantial experience in commercial real estate financing. Neither report asserts that the section 10 phrase "on behalf of the Participants," or any other term of the Participation Agreement, has a specialized meaning in the industry. Moreover,

[6] In Law Debenture Trust Co., the Second Circuit reasoned that "[a]n ambiguity exists where the terms of the contract could suggest more than one meaning when viewed objectively by a reasonably intelligent person who has examined the context of the entire integrated agreement and who is cognizant of the customs, practices, usages and terminology as generally understood in the particular trade or business." (595 F3d at 466 [internal quotation marks and citation to earlier federal authority omitted].) This case has been interpreted as holding that, under New York law, extrinsic evidence of custom and usage as to specialized terms is "properly considered in making the threshold ambiguity determination with respect to" disputed contractual language. (FCCD Ltd. v State St. Bank & Trust Co., 2011 WL 519228, * 5 [SD NY Feb. 15, 2011 No. 10 Civ 1632] [DLC].)

both reports offer opinions as to the subjective intent of the parties.

The Stein report opines, for example, that "Junior Participant could reasonably have expected that the Owning Entity Requirement [in section 10] would apply based on the [Participation] Agreement's terms, and based on ordinary expectations and standards in the lending marketplace." (Stein Report, ¶ 79.) The report does not, however, cite any evidence or authority documenting such standards.

The Cotton report offers an opinion as to the parties' intent based on review of the parties' negotiations, and consideration of market conditions, prior to the parties' entry into the Participation Agreement. The report thus states: "I believe that LBHI entered into the Participation Agreement in order to avoid recognizing a loss of $12 million on the Junior Mezzanine Loan that it wished to sell to IVC. In turn, IVC wished to have unfettered rights to protect its investment position in the event of a borrower's default, and did not intend to provide LBHI with any rights to protect its participation interest in the event of a borrower's default." (Cotton Report, ¶¶ 15 [a], 16.) The report further opines, based on the parties pre- and post-closing conduct, that the parties understood that LBHI's Junior Participation Interest "had no economic value," and that "LBHI had no expectation of receiving any economic value from its junior participation interest until IVC received the full face amount of its senior participation interest . . . in the event of a borrower's default." (Id., ¶15 [b] – [d].)

Both experts' reports also offer opinions as to the ultimate legal issues in this action. The Stein report, for example, concludes that when IVC "conducted the Junior Foreclosure and acquired the Equity Interest . . . , it could have acted only in its capacity as holder of the Junior Mezzanine Loan under the [Participation]Agreement, on behalf of both Participants." (Stein

Report, ¶ 82.) "If Senior Participant in fact acquired the Equity Interests at the Junior Foreclosure, then I believe industry standards would contemplate that Senior Participant did that on behalf of the Participants and in accordance with the Owning Entity Requirement." (Id., ¶ 89.) The Stein report also opines that in the case of a credit bid, "there would be no cash purchase price to run through the Waterfall. Instead of having a security interest in the Equity Interests, the Participants would have jointly acquired outright ownership, acting through Senior Participant, by virtue of the Owning Entity Requirement." (Id., ¶ 86.) The Stein report asserts that industry standards contemplate that "even if a co-lender is 'out of the money' and has no control rights, that co-lender still retains its economic rights if things turn out well after all. That includes the case where the co-lenders acquire the collateral as REO [real estate owned] and then eventually sell it at a profit." (Id., ¶ 74.)

The Cotton report offers directly conflicting opinions on these issues. The report opines that "Section 10 of the Participation Agreement, which expressly incorporates and does not change the parties' respective 'economic interests' or the terms of the Participation Agreement, did not require IVC to form the Owning Entity." (Cotton Report, ¶ 15 [g].) The report further reasons: "Section 5 of the Participation Agreement . . . is about as one-sided as I have ever seen in such a document." (Id., ¶ 27.) Noting that LBHI initially proposed that section 5 provide that the Senior Participant shall not do anything that would disproportionately and adversely affect the Junior Participation Interest, and that LBHI ultimately agreed to preface this clause with the phrase "unless an Event of Default shall have occurred," the report concludes that "that language gives the Senior Participant total and complete control and power to protect its own interests and to perfect on its collateral." (Id., ¶¶ 25, 27.) The Cotton report further opines that the section 4

(d) post-default waterfall provision applies to IVC's $1 million credit bid, which constituted "proceeds" to be paid out entirely to IVC under the waterfall. (Id., ¶¶ 42-43.)

The Stein report characterizes section 10 as a "hope certificate," providing "the possibility of some future payout." (Stein Report, ¶ 63.) The Cotton report refers to the structure of the Participation Agreement as a "hope note," but concludes that it would have "no real value unless the underlying value of the collateral exceeded, or at least equaled, the face value of the loan." (Cotton Report, ¶ 23.) Neither expert provides any substantiation for these opinions, or the opinions discussed above, other than his own expertise and conclusory references to industry standards (Stein Report e.g. ¶¶ 72, 74) or what the parties "would have known," given their experience in the industry. (Cotton Report, ¶ 23.)

In offering opinions as to the proper construction of the Participation Agreement, both expert reports contravene the well settled principle that "expert witnesses should not be called to offer opinion as to the legal obligations of parties under a contract" – an issue for the court. (Colon v Rent-A-Center, Inc., 276 AD2d 58, 61 [1st Dept 2000]; Northeast Restoration Corp. v T.A. Ahern Contrs. Corp., 132 AD3d 552, 553 [1st Dept 2015].) Moreover, as noted above, although both reports refer to industry customs and practices, the experts' analysis of customs and practices is conclusory. Both reports fail to discuss, or provide support for, the experts' claims as to specific customs or practices relevant to the capacity in which IVC was required to act at the foreclosure. The experts' reports accordingly do not provide evidence sufficient to enable this court to resolve the ambiguity in the Participation Agreement as to whether IVC was obligated to act on LBHI's behalf in foreclosing on the Junior Mezzanine Loan collateral, thus triggering the section 10 Owning Entity requirement.

Nor do the parties otherwise submit evidence sufficient to resolve this ambiguity. IVC emphasizes LBHI's compromises as to contractual terms during the negotiations regarding the Participation Agreement, and IVC's negotiators' assertions as to IVC's subjective intent to avoid any provision that would inhibit IVC's ability to protect its position. (See Def.'s Memo. In Supp. at 6, citing Dep. of Christopher Sameth at 96 [Shaiman Aff. In Opp. to Pl.'s Motion, Ex. 16] [Shaiman Aff.].) In addition, IVC cites the parties' post-foreclosure conduct, including evidence that allegedly shows that LBHI itself attributed no value to its Junior Participation Interest. (Id. at 7, 24.) LBHI does not dispute that IVC had control over the foreclosure and very limited obligations to LBHI under the Participation Agreement. Rather, LBHI argues that "the applicability of section 10 is not contingent upon the value" of LBHI's Interest, and that if the parties had intended that section 10 "only apply if LBHI's position were in the money, they could have inserted language to the effect." (Pl.'s Reply Memo. at 6.) As stipulated by the parties, "the Participation Agreement does not include the words 'valuation,' 'appraisal,' or 'values.'" (Joint Statement, ¶ 25.) As discussed above, the parties' experts also dispute the effect of the value of LBHI's Interest on IVC's obligations under section 10. On this record, this court cannot find that the extrinsic evidence resolves the ambiguity in the Participation Agreement as to whether section 10 imposed an obligation on IVC to foreclose on both IVC's and LBHI's behalf, regardless of the value of LBHI's Interest.

Moreover, LBHI disputes the parties' post-foreclosure conduct, and contends that IVC initially agreed to formation of an Owning Entity for the Equity Interests acquired at the foreclosure. LBHI thus cites an email from LBHI's counsel to LBHI, dated October 18, 2011, shortly after the foreclosure, stating that Investcorp's counsel "called and said Investcorp

greenlighted going ahead with the LLC." (Fine Aff. In Supp. of Pl.'s Motion, Ex. 2.) This evidence is itself disputed by IVC's witnesses, who appear to acknowledge that they received a draft from LBHI of an Owning Equity agreement, but denied that they were willing to consider it. (Def.'s Memo in Opp. to Pl.'s Motion at 12, citing Sameth Dep. at 263-264 [Shaiman Aff., Ex. 16] and Dep. of Christopher Hoeffel at 222, 226, 235 [Shaiman Aff., Ex. 14].)

In sum, resolution of the ambiguity in the Participation Agreement must await trial, at which credibility disputes as to the parties' intent may be resolved, and more specific expert testimony may be elicited on industry standards relevant to the capacity in which IVC was required to act at the foreclosure.7

It is accordingly hereby ORDERED that the motion of plaintiff, Lehman Brothers Holdings Inc., and the motion of defendant, IVC WH HG II, LLC, for summary judgment are denied.

This constitutes the decision and order of the Court.

Dated: New York, New York
August 31, 2016

Marcy Friedman
MARCY FRIEDMAN, J.S.C.

7 In view of this threshold issue as to whether the Owning Entity requirement of section 10 was triggered, the court does not reach the further issue of what the parties' respective interests would be in the Owning Entity – i.e., whether the term "same economic interests" is equivalent to the term "Percentage Interests" as defined in the Participation Agreement. (See Pl.'s Memo. In Supp. at 12-14; Def.'s Memo. In Opp. at 23-24.)