Finance ADVISORY

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New York Appellate Court Upholds Plain Meaning of Reserve Provision in CMBS Loan Agreement

By John P. Doherty, Gerard C. Keegan, Robert J. Sullivan, and David C. Wohlstadter

On October 24, 2017, a New York appeals court unanimously affirmed dismissal of a CMBS borrower's lawsuit concerning the interpretation of a reserve provision in a commercial loan agreement.

The dispute concerned the plaintiff's request to the defendants to release funds from a rollover reserve account, which was established to fund tenant improvements and leasing commissions (TI/LC) at the plaintiff's property in Austin, Texas. Pursuant to the rollover reserve provision, the plaintiff was obligated to deposit a sum certain at closing, make monthly payments to "achieve" a certain balance as of a date certain, "and thereafter maintain such balance." Consistent with this language, the defendants took the position that the rollover reserve created a minimum balance requirement as of the date certain. In response, the plaintiff argued that the provision did not create a minimum balance, but rather was intended to ensure that sufficient rollover reserve funds would be available when the key tenant's lease expired on that same date. The plaintiff further argued that the required balance in the rollover reserve was, in fact, the projected estimate of TI/LC costs in connection with the tenant's lease expiration.

In support of its position, the plaintiff obtained a written statement from the law firm that represented the original lender stating that the rollover reserve was intended to be used for the tenant lease termination and the "thereafter maintain such balance" language was not intended to create a minimum balance requirement. The plaintiff further argued that it made little commercial sense to be required to maintain more than 10% of the loan's balance in a reserve account that was earmarked for TI/LC for the last seven years of a 10-year loan, yet it was unable to access those funds during the life of the loan.

In mid-2016, the trial court granted the defendants' motion to dismiss following oral argument from the bench and referred the defendants' motion for attorneys' fees pursuant to the loan agreement to a special referee. The court held that the rollover reserve provision was clear and unambiguous and that the parties' intent must be gleaned from the plain language of the contract. The court rejected the plaintiff's argument that the rollover reserve was intended for the tenant lease expiration—even though they were both keyed to the same date—and held that if the sophisticated parties intended that the rollover reserve would be available for the lease termination, they should have said so.

The court refused to consider parol evidence (the letter from the prior lender's counsel) to interpret an unambiguous contract. In that regard, the court held that the views of the prior lender's counsel were irrelevant because it "has no dog in the hunt" and noted that a purchaser of a loan should be able to rely on the loan documents as written without regard to "some secret, back-pocket understanding that the borrower and lender might have had."

On appeal, just weeks after oral argument, the four-judge panel unanimously affirmed dismissal of the case, adopting the defendants' argument that the loan terms were clear, that the loan agreement was internally consistent, and that, therefore, parol evidence should not be considered.

The defendants are represented by John P. Doherty and David C. Wohlstadter of Alston & Bird LLP. The matter is *Harvest 12708 Riata LLC v. Wells Fargo Bank N.A., et al.,* No. 650931/2016 (Sup. Ct. N.Y. Cnty.)

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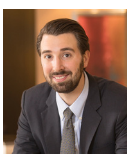

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