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NYC Office Guarantors Fight 'Surrealistic' Recourse

By **Georgia Kromrei**

Law360 (August 12, 2024, 7:03 PM EDT) -- The guarantors of financing on a Midtown Manhattan office building sued the lender Aug. 8, saying it tricked the borrower into an arrangement that could leave the guarantors liable for the full loan amount and attorney fees in a separate federal lawsuit.

The dispute between multiple guarantors and their lender revolves around a $23.5 million loan for improvements at a Manhattan office building on East 57th Street. (Anthony Behar/Sipa via AP Images)

It came as a surprise to plaintiffs — the Natixis-owned AEW Partners Real Estate Fund VIII LP, Earlin Investment LP and ABS Real Estate co-managing partners Gregg Schenker and Steven Hornstock — that the loan, for improvements on what they said is a now-worthless ground lease at 136 E. 57th St., would be full-recourse. The borrower — the guarantors' affiliate, P8 — stopped making payments on the $23.5 million loan in November 2023. A month later, rather than try to take control of the collateral, the lender Cerco quickly sued the guarantors in New York federal court.

The guarantors allege **in their state court complaint** that Cerco kept the borrower's counsel in the dark about its intentions to interpret the guaranty as full-recourse, in contrast to the limited-recourse terms the guarantors believed the borrower had negotiated.

"It was a strategy hearkening back to the works of the painter Magritte — but instead of 'Ceci n'est pas une pipe,' Cerco claimed 'this is not a carve-out guaranty' and began to take actions, including litigation, based on their surrealistic strategy, causing plaintiffs to incur significant expenses, all in direct contradiction of Cerco's own repeated misrepresentations," the guarantors claimed.

The loan was meant to fund renovations at the building that would make it a "premier, boutique mixed-use commercial property situated within Midtown Manhattan's 57th Street corridor," the guarantors said.

In October 2023, P8 told Cerco the value in the ground lease was wiped out due to conditions in the commercial real estate market that, in Manhattan, had "deteriorated significantly and unexpectedly" in the months since the loan was made. P8 offered to bypass the arduous judicial foreclosure process and hand over the ground lease, or allow a receiver to be appointed. The next week, the borrower defaulted.

Instead of accepting a deed in lieu of foreclosure, Cerco demanded full payment from P8, down to each rent payment, loan payment, and the loan principal, and in December 2023 it sued the individual guarantors, Schenker and Hornstock, in the Southern District of New York.

Its choice to go after the individual guarantors, and not the AEW and Earlin funds, each based in Delaware, was a calculated strategy to avoid the New York state courts, the guarantors claim. Otherwise, Cerco would have been "forced" to bring its claims before a court that is "well-versed in the customs and practices of the New York commercial real estate market and would have easily recognized the lack of merit in Cerco's contrived interpretation of the guaranty."

In commercial real estate transactions with nonrecourse provisions, full recourse is only invoked when a handful of "bad boy" events occur, such as a borrower filing for bankruptcy protection or taking on new debt. The structure makes it possible, in some cases, for borrowers to shrug their shoulders at loan obligations when assets do not perform as expected.

According to the guarantors, Cerco planned to close off that avenue to the borrower and make the guarantors pay for "its perceived losses," rather than taking the ground lease back. The guarantors said Cerco is pursuing "without limitation" the attorney fees in the federal lawsuit.

The guarantors are hoping the lender's litigation strategy will backfire, however. Testimony in the federal case could help the guarantors' efforts to argue that they never agreed to a loan with a full-recourse guaranty, they argued.

During a deposition taken in the federal case, the plaintiffs claimed Cerco CEO Peter Cervinka said a day before signing the loan that he didn't know that the loan would not be full-recourse. In the deposition, Cervinka called it a "mistake" and said he wouldn't do the deal without one.

The guarantors also say that Fox Rothschild LLP, which is representing Cerco in the federal lawsuit but is not named as a defendant in the state lawsuit, helped to keep the borrower in the dark about the intention to interpret the loan as full-recourse.

"Counsel for plaintiffs either did not read, did not understand the facts, or has engaged in a willful distortion of the record," said Jeffrey Pollock, a partner at Fox Rothschild, who represents Cerco in the federal lawsuit. "In either event, we will be pursuing sanctions because this is a frivolous filing. This is textbook example of filing for harassment or malicious injury under Rule 3.1 Non-Meritorious Claims and Contentions."

Fox Rothschild "played an integral role in at least some" of the fraud, according to the guarantors, based on deposition taken in the federal action, and "further evidence may well confirm" that Fox Rothschild and Matt Lubart, a New Jersey-based partner at the firm, should be added as defendants.

Attorneys for the individual guarantors in the federal lawsuit in July asked the court to impose sanctions on Cerco's attorneys, after Cerco's CEO skipped a May deposition.

AEW Partners Real Estate Fund VIII LP, Earlin Investment LP, Gregg Schenker and Steven Hornstock are represented in the state case by Robert S. Landy and Amy C. Brown of Ford O'Brien Landy LLP.

Counsel information for Cerco in the state case was not immediately available Monday.

The state case is AEW Partners Real Estate Fund VIII LP, Earlin Investment LP, Gregg Schenker and Steven Hornstock v. Cerco Bridge Loans 6 LLC, in the Supreme Court of the state of New York, County of New York, Commercial Division. An index number has not yet been assigned.

Gregg Schenker and Steven Hornstock are represented in the federal case by James P. Fogelman, Gabriel

Herrmann, Diane Chan and Michael Klurfeld of Gibson Dunn & Crutcher LLP.

Cerco Bridge Loans 6 LLC is represented in the federal case by Jeffrey M. Pollock of Fox Rothschild LLP.

The federal case is Cerco Bridge Loans 6 LLC v. Gregg Schenker and Steven Hornstock, case number 1:23-cv-11093, in the U.S. District Court for the Southern District of New York.

--Editing by Haylee Pearl.