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New York State Supreme Court Decision Continues Uncertainty as to Enforceability of Dual Collateral Real Estate Loans

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Historically, New York has adopted the doctrine "against clogging" a borrower's equitable right of redemption in mortgaged real property (the "Doctrine").[1] The Doctrine originated in English courts of equity to protect borrowers against forfeiture of their real estate when the mortgage contained language granting irrevocable title to the mortgagee upon the most minor default. The Doctrine denied lenders specific performance of such provisions and thus protected the borrower's equitable right of redemption to buy back the property (in modern terms, the right to rescue the property from foreclosure by paying the indebtedness).[2]

In the commercial real estate lending space, and notably in the context of financing distressed assets, it has become common practice for lenders to structure financings whereby a single loan is secured by both a traditional mortgage and by a pledge of the equity interests in the mortgage borrower (a "dual collateral" loan). This practice theoretically allows the lender the option to pursue a relatively speedy UCC foreclosure on the pledge of equity rather than the lengthy process of judicial foreclosure of the mortgage.[3] The consensus among many New York real estate practitioners, however, is that enforcing the pledge of equity in the borrower in a dual collateral loan effectively clogs the borrower's right of redemption by preventing the borrower from paying off the debt and redeeming the asset before consummation of a judicial foreclosure.

In 2018, the Supreme Court, New York County decided a case commonly known as "*HH Cincinnati*,"[4] which contained a clogging claim and sought, among other things, to preliminarily enjoin a UCC auction of the equity interests in the borrowers. Without belaboring the background of *HH Cincinnati*, some New York real estate finance practitioners argued that language in the *HH Cincinnati* opinion was authority for the proposition that dual collateral loans are enforceable in New York. Specifically, the *HH Cincinnati* Court seemed to substantively reject the borrowers' clogging argument by stating that the borrowers "retain[ed] a right of redemption under UCC Section 9-623, which provides that redemption may occur at any time before a secured party disposes of the collateral at a foreclosure sale."[5] But did the Court really find that dual collateral loans are enforceable? The quoted statement was arguably non-binding dicta, and the decision only involved the denial of borrowers' application for the equitable remedy of preliminary injunction on the ground that borrowers had an adequate remedy at law (monetary damages). Thus, whether the Court's statement truly supported the enforceability of dual collateral loans was questionable.

After the HH Cincinnati decision was issued, the lender sold the equity interests in the borrowers at a UCC auction and acquired the equity of the borrowers by a credit bid.[6] The borrowers and guarantors of the original loan then sued the lender again, in a case now known as *HH Mark Twain LP. v. Acres Capital Servicing LLC* ("*HH Mark Twain*").[7]

The *HH Mark Twain* Court—the same court that issued the decision in *HH Cincinnati*—has now upheld the borrowers' claim that the UCC auction was commercially unreasonable, and, notably, upheld the borrowers' cause of action for a declaration that the loan documents and UCC sale were void because the dual collateral structure of the loan violated the Doctrine. The Court made clear that the language quoted above from the *HH Cincinnati* decision was indeed not binding[8] by stating that it had not (in the *HH Cincinnati* decision) "ruled on the merits of the …clogging claim"[9] and, as a result, the Court allowed the borrowers and guarantors to pursue their clogging claims under the Doctrine. However, the Court did not hold that dual collateral loans are either permissible or impermissible. Thus, the enforceability of dual collateral loans in New York remains uncertain, and lenders should be wary of the potential for loan documents to be declared void and unenforceable if a New York Court finds that they violate the Doctrine.[10]

1. *See, e.g., Lawrence v. Farmers' Loan & Trust Co.*, 13 N.Y. 200,255 (1855); *Slee v. Manhattan Co.*, 1 Paige Ch. 48, 56 (N.Y. Ch. 1828).
2. The doctrine dates back to at least 1639. *See* Norstrand, *The Convertible Mortgage and the Equity of Redemption*, 26 B.B.J. 24, 25 (Sept. 1982).

3. Non-judicial foreclosure (i.e., foreclosure by "power of sale") is not available in New York. N.Y. Real Prop. Acts. Law §§ 1401-21 (McKinney 2008) (repealed July 1, 2009).
4. HH Cincinnati Textile L.P., 2018 N.Y. Misc. LEXIS 2472 (Sup.Ct., N.Y. County, June 19, 2018).
5. *Id*. At *4.
6. There were no third-party bidders.
7. *HH Mark Twain LP. V, Acres Capital Servicing LLC*, 2020 N.Y. Misc LEXIS 2515 ((Sup.Ct., N.Y. County, June 2, 2020).
8. *Id*
9. *Id*. at *3-4.
10. *See, e.g., Clark v. Henry*, 2 Cow. 324, 327 (N.Y. Sup. Ct. 1823) ("all agreements of the parties, tending to alter in any subsequent event the original nature of the mortgage and prevent the equity of redemption, are void"); *Henry v. Davis & Clark*, 7 Johns.Ch. 40, 42 (N.Y. Ch. 1823), aff'd sub nom. Clark, 2 Cow.; *Massari v. Girardi*; 119 Misc. 607, 608 (Sup. Ct. Kings Cty. 1922) ("any agreement...preventing the equity of redemption is void").