

**IN THE COURT OF COMMON PLEAS OF PHILADELPHIA COUNTY
FIRST JUDICIAL DISTRICT OF PENNSYLVANIA
TRIAL DIVISION - CIVIL**

LEM FUNDING XXXV, L.P., and LEM : SEPTEMBER TERM, 2009
PARALLEL XXXV, L.P., :
 : NO. 01296
 :
 : COMMERCE PROGRAM
 :
 v. :
 : Control Nos. 1004083,1004084,
 SOVEREIGN BANK, : 10051161
 :
 :
 Defendant. :

SOVEREIGN BANK, : JANUARY TERM, 2010
 :
 Plaintiff, : NO. 00098
 :
 v. : Control Nos.: 10040670, 10040672

LEM FUNDING XXXV, L.P., and LEM :
PARALLEL XXXV, L.P., :
 :
 Defendants. :

ORDER

AND NOW, this 23rd day of June, 2010, upon consideration of the parties' Cross-Motions for Summary Judgment, the responses in opposition, the briefs in support and opposition, all other matters of record, and after oral argument and in accord with the Opinion issued contemporaneously, it is **ORDERED** that:

1. Motion - - Control number - - 10040803 is **GRANTED in part**.
 - A. Count I of the Complaint of LEM Funding XXXV, L.P. and LEM Parallel XXXV, L.P. is limited to a claim for recovery of attorneys' fees incurred in "litigation affecting the Loan or the security for the Loan."

- B. Count III of the Complaint of LEM Funding XXXV, L.P. and LEM Parallel XXXV, L.P. is limited to a claim for interest payments made to Sovereign Bank after the Maturity Date of the Loan.
- C. Count IV of the Complaint of LEM Funding XXXV, L.P. and LEM Parallel XXXV, L.P. is **DISMISSED**.
- D. **JUDGMENT** is **ENTERED** in favor of Sovereign Bank and against LEM Funding XXXV, L.P. and LEM Parallel XXXV, L.P. on Counts II and III of Sovereign Bank's Counterclaim in the amount of \$280,232.70, plus six percent (6%) interest running from May 18, 2009 through the date of satisfaction. Within ten (10) days of the date of entry of this Judgment, Sovereign Bank shall satisfy such Judgment out of the funds it holds as Interest Reserve Collateral.
2. Motion - - Control number - - 10040672 is **GRANTED**. **JUDGMENT** is **ENTERED** in favor of Sovereign Bank and against LEM Funding XXXV, L.P. and LEM Parallel XXXV, L.P. on Counts I and II of Sovereign Bank's Complaint, and it is **ORDERED** that LEM Funding XXXV, L.P. and LEM Parallel XXXV, L.P. shall convey title to the real property situate at 2202 Colonial Park Drive, Tampa, FL, 225 E. 131st Avenue, Tampa, FL, and 1426 Marathon Key Drive, Tampa, FL to Sovereign Bank within thirty (30) days of the date of entry of this Order.
3. Motions - - Control numbers - - 10040670 and 100040804 are **GRANTED in part**. Count I of Sovereign Bank's Counterclaim is **DISMISSED**.
4. The remaining prayers for Summary Judgment Motions are **DENIED**.

It is further **ORDERED** that Sovereign Bank's Motion for Leave to Amend its Counterclaim is **DENIED**.

BY THE COURT,

ALBERT W. SHEPPARD, JR., J.

**IN THE COURT OF COMMON PLEAS OF PHILADELPHIA COUNTY
FIRST JUDICIAL DISTRICT OF PENNSYLVANIA
TRIAL DIVISION - CIVIL**

LEM FUNDING XXXV, L.P., and LEM PARALLEL XXXV, L.P.,	:	SEPTEMBER TERM, 2009
	:	NO. 01296
Plaintiffs,	:	COMMERCE PROGRAM
v.	:	Control Nos. 1004083,1004084 10051161
SOVEREIGN BANK,	:	
Defendant.	:	

SOVEREIGN BANK,	:	JANUARY TERM, 2010
	:	NO. 00098
Plaintiff,	:	Control Nos.: 10040670, 10040672
v.	:	

LEM FUNDING XXXV, L.P., and LEM PARALLEL XXXV, L.P.,	:	
	:	
Defendants.	:	

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OPINION

Albert W. Sheppard, Jr., J. June 23, 2010

These consolidated cases involve a dispute between two joint venturers who loaned money (the “Loan”) to a defaulting third-party (the “Borrower”). Under the parties’ Amended and Restated Participation Agreement (the “Agreement”), Sovereign Bank (“Sovereign”) contributed \$30 million, which is roughly 83% of the Loan funds, and LEM Funding XXXV, L.P. and LEM Parallel XXXV, L.P. (“LEM”) contributed \$6.2 million, or just over 17%. LEM

also served as “Lead Lender” responsible for “making, servicing, and administering the Loan” on behalf of both itself and Sovereign.¹

The following is a history of the Loan and its aftermath:

<u>Date</u>	<u>Event</u>
February, 2006	Agreement signed by LEM and Sovereign. Mortgage Loan made to Borrower secured by three apartment properties in Florida (the “Property”).
March, 2006	Borrower defaulted on Loan. LEM began making “Protective Advances” with respect to the Property.
April, 2006	LEM entered into Forbearance Agreement with Borrower.
June, 2006	First Amendment and Modification to Agreement signed by LEM and Sovereign. LEM began making “Non-Default Interest Payments” to Sovereign in exchange for Sovereign’s consent to Forbearance Agreement with Borrower.
September, 2006	LEM and Sovereign hired Klehr Harrison to represent them in proceedings against the Borrower. A default was declared against the Borrower under the Loan documents and the Loan was accelerated.
October, 2006	LEM filed an action against the Borrower in Florida state court to enforce the Loan Note and Mortgage.
November, 2006	Second Amendment and Modification to Agreement signed by LEM and Sovereign.
March, 2008	LEM obtained Judgment on the Loan Note, and the Mortgage was foreclosed.
April, 2008	LEM took title to the Property after foreclosure.
November, 2008	Value of Properties decreased substantially. LEM ceased to make Non-Default Interest Payments to Sovereign. Sovereign demanded repayment of its “Participation Share” of \$30 million. LEM demanded a refund of the Non-Default Interest Payments made and reimbursement of a portion of the Protective Advances LEM made with respect to the Property.
May, 2009	LEM executed on Florida Judgment against \$280,232.70 of the Borrower’s funds held in escrow by Klehr Harrison. LEM used these

¹ Agreement § 4.4.

funds to repay itself for Protective Advances it made with respect to the Property.

September, 2009 LEM filed the first of these consolidated actions.

The parties' remaining claims in these consolidated actions are as follows:

LEM v. Sovereign Complaint

Count I – Sovereign breached the Agreement by failing to pay its proportionate share of the Protective Advances.

Count III – Sovereign was unjustly enriched by the Non-Default Interest Payments made by LEM.

Count IV – LEM is entitled to a declaratory judgment that it gets repaid for the Protective Advances first upon sale of Property.

Sovereign v. LEM Counterclaim

Count I – LEM breached the Agreement by failing to purchase Sovereign's \$30 million Participation Share.

Count II – LEM breached the Agreement by failing to pay Sovereign the \$280,232.70 it seized in partial satisfaction of the Florida Judgment.

Count III – Sovereign is entitled to set off the Interest Reserve Collateral against monies owed to it by LEM.

Sovereign v. LEM Complaint

Count I – Sovereign is entitled to specific performance and an injunction requiring LEM to transfer the Property to Sovereign.

Count II – Sovereign is entitled to a declaratory judgment that LEM must transfer the Property to Sovereign.

The parties have cross-moved for summary judgment on these claims, which motions are presently before the court.

I. LEM Should Have Paid The \$280,232.70 It Seized To Sovereign.

The repayment terms of the Agreement are straightforward. While the Loan is performing well, LEM and Sovereign are supposed to share all principal repayments pro rata.² If the Loan goes into default, Sovereign is supposed to receive 100% of the amounts recovered,

² Agreement § 3.2(a).

other than those recovered under the guarantees.³ The amounts recovered under the guarantees are to be paid according to a disbursement schedule that includes repayment of a portion of Sovereign's Participation Share in first place.⁴

The Loan went into default almost immediately. The Borrower's money, which was held in escrow by Klehr Harrison and seized by LEM, constituted proceeds from a source other than the collateral. It was not sums received on account of any guaranty.⁵ Therefore, under Section 3.2(b), LEM was supposed to pay 100% of the Klehr Harrison escrow money to Sovereign.

II. LEM Is Not Entitled To Repayment Of The Protective Advances Before Sovereign Is Repaid.

LEM argues that it was entitled to use the money it seized from Klehr Harrison to repay itself for Protective Advances⁶ it made with respect to the Property after the Borrower's default. The Agreement does not say so. The only mention of repayment of Protective Advances is contained in Section 3.2(c). Under that Section, Protective Advances are to be paid out of sums received on account of the Repayment Guaranty and/or the Guaranty, but only after Sovereign is repaid \$12,090,000 of its Participation Share and LEM is paid \$6,010,000 of its Participation Share.

³ Agreement § 3.2(b) ("Subject to Section 3.2(c) below, until [Sovereign's] Participation Share is reduced to zero, [LEM] shall pay to [Sovereign] . . . from and after the occurrence and during the continuance of an Event of Default, one hundred percent (100%) of any and all sums received by [LEM] on account of the Loan from Borrower . . . as proceeds of any collateral for the Loan or from any other source . . . ("Section 3.2(b)"))).

⁴ Agreement § 3.2(c) ("Until [Sovereign's] Participation Share is reduced to zero, sums received by [LEM] on account of the Repayment Guaranty and/or the Guaranty shall be disbursed as follows: (i) First, an aggregate amount equal to \$12,090,000.00 shall be paid to [Sovereign]; (ii) Second, an aggregate amount equal to \$6,010,000.00 shall be paid to [LEM]; (iii) Third, an amount equal to all outstanding Protective Advances shall be paid to [LEM] . . . ("Section 3.2(c)"))).

⁵ Even if it was guaranty money, it should have been paid to Sovereign first under the disbursement schedule set forth in Section 3.2(c) of the Agreement.

⁶ Agreement, p. 3 ("Protective Advances' means all sums advanced by Lead Lender for the protection of the security given in the Mortgage, including, without limitation, the unpaid balances of advances made with respect to the Property for the payment of taxes, assessments, maintenance charges, insurance premiums and costs incurred by Lead Lender for the protection of the property or the lien of the Mortgage.")

LEM relies upon another provision of the Agreement to argue that it gets repaid first, before Sovereign:

All monies collected or received by [LEM] in connection with the Loan or the Loan Documents following the occurrence of an Event of Default under the Loan Documents shall be applied to the obligations of Borrower under the Loan in accordance with the terms of the Loan Documents and to the greatest extent possible in a manner consistent with the intent of Section 3.2 of this Agreement.⁷

This provision does not address repayment of Protective Advances, but instead speaks to the use of funds LEM receives to pay the Borrower's obligations. If LEM had collected any funds while the Loan was in default and prior to foreclosure, it might have been able to justify using them to pay certain of the Borrower's obligations like taxes or insurance. LEM did not collect any such funds during that time period. Instead, LEM seized the Borrower's funds from Klehr Harrison after LEM had obtained a Judgment against the Borrower based on the Loan Note and Mortgage. Both parties agree that the Loan Documents merged into the Judgment. Such a merger extinguishes the obligations the Borrower had under the Loan Documents.

Since the Borrower no longer had any Loan obligations, other than to pay the Judgment amount, the funds seized by LEM could not be "applied to the obligations under the Loan in accordance with the terms of the Loan Documents." Instead, LEM should have applied those funds in accordance with Section 3.2, which requires payment of 100% of such funds to Sovereign.

Since the Agreement does not give LEM any priority with respect to repayment of the Protective Advances, the court must dismiss LEM's claim for a declaratory judgment that it gets paid first upon sale of the Property.

⁷ Agreement §4.3.

III. Sovereign May Set-Off A Portion Of The Interest Reserve Collateral Against The \$280,232.70 Due From LEM.

Under the Second Amendment to the Agreement, LEM agreed to continue making Non-Default Interest Payments to Sovereign until the “Maturity Date” of the Loan “as defined in the Loan Agreement.”⁸ As security for this obligation, the Second Amendment required LEM to deposit money with Sovereign as “Interest Reserve Collateral.”⁹ Sovereign currently holds over \$475,000 as such collateral. The Second Amendment anticipates that, once LEM fulfills its obligation to pay Sovereign interest, the collateral will be returned to LEM.¹⁰ Nothing in the parties’ Agreement, as amended, prohibits Sovereign from setting-off or executing against such funds to pay a debt that LEM owes to Sovereign. Therefore, Sovereign may satisfy the \$280,232.70 judgment against LEM out of the Interest Reserve Collateral.

IV. LEM’s Breach Of Contract Claim Regarding Protective Advances Is Limited To Recovery Of Certain Attorneys’ Fees.

LEM claims that Sovereign must reimburse LEM for its pro rata share ($\approx 83\%$) of the Protective Advances LEM made on behalf of the Property. Nothing in the parties’ Agreement, as amended, requires Sovereign to do so. Instead, the Agreement contemplates that LEM alone will bear the burden of paying Protective Advances,¹¹ and that LEM will face the risk of not being repaid.¹²

⁸ Second Amendment §3(a)(ii).

⁹ Second Amendment §4(a).

¹⁰ Second Amendment §4(c).

¹¹ Agreement, p. 3 (“Protective Advances” means all sums advanced by [LEM] for the protection of the security given in the Mortgage . . .”).

¹² Agreement §3.2(c) (Protective Advances may be repaid out of guaranty funds received, but only after significant portions of Sovereign’s and LEM’s Participation Shares have already been repaid).

LEM argues that the following provision gives it the right to demand reimbursement from Sovereign:

In consideration for the payment by [Sovereign] of its Participation Share to [LEM], [LEM] hereby grants and assigns to [Sovereign], and [Sovereign] hereby purchases and accepts from [LEM], the undivided fractional interest [≈83%] in the Loan and the rights and obligations of [LEM] under or in connection with the Note and other Loan Documents. . . .”¹³

LEM claims that, by purchasing 83% of LEM’s “obligations” under the Loan Documents, Sovereign purchased 83% of LEM’s Protective Advance liability. However, LEM’s obligation to pay the Protective Advances is not set forth in the Loan Documents; the Loan Documents give LEM the right, but not the obligation, to pay sums to protect the Property. To the extent that LEM has an obligation to make Protective Advances, that obligation arises under the parties’ Agreement, not under the Loan Documents.¹⁴

The Agreement does not require Sovereign to share LEM’s obligation, except to the extent that the Protective Advances sought by LEM constitute legal fees and expenses incurred “in the event of actual or threatened litigation affecting the Loan or security for the Loan.”¹⁵ In that case, “if the Borrower fails to pay such fees and expenses, then [LEM and Sovereign] shall pay their fractional share thereof.”¹⁶ Therefore, LEM may demand that Sovereign pay its pro rata share of any attorneys’ fees incurred in litigation affecting the Property in accord with the terms of the parties’ Agreement.

¹³ Agreement §2.1(b).

¹⁴ See Agreement §4.8 (LEM must “administer the Loan with the same care as it would exercise if it were administering the Loan for its own account in the absence of Participants.”); Second Amendment §§ 5,6 (LEM “at its sole cost and expense” shall make capital improvements and hire a management company once it takes title to the Property.)

¹⁵ Agreement §4.6.

¹⁶ *Id.*

V. LEM's Unjust Enrichment Claim Is Limited To Non-Default Interest Paid After The Maturity Date Of The Loan.

LEM claims that Sovereign was unjustly enriched by LEM's payment of interest to Sovereign after the Loan went into default. Sovereign claims that the parties' Agreement, as amended, required LEM to make such payments and requires LEM to continue making such payments.¹⁷ The Second Amendment provides:

[LEM and its affiliates] guarantee to pay to [Sovereign] and become surety to [Sovereign] for:

* * *

cash payments of each Non-Default-Interest Payment on each Interest Payment Date; provided that LEM guarantors shall no longer be obligated under this subsection 3(a)(ii) from and after the earlier to occur of . . . (2) the Maturity Date (as defined in the Loan Agreement) . . .¹⁸

The Loan Agreement defines "Maturity Date" as the "date on which the final payment of principal of the Note becomes due and payable as therein or herein provided, whether at such stated maturity date, by declaration of acceleration, or otherwise."¹⁹ LEM accelerated the Loan in September, 2006, so that was the Maturity Date of the Loan.

The parties executed the Second Amendment in November, 2006, two months after the Maturity Date had already occurred. In the Second Amendment, the parties imposed an additional obligation on LEM to pay interest to Sovereign, yet they agreed that the obligation expired on the previously occurring Maturity Date. Despite the prior occurrence of the Maturity Date, LEM made the interest payments to Sovereign for approximately two years, until November 2008. Since the parties' actions do not comport with the express terms of their

¹⁷ See Sovereign's Motion to Amend Counterclaim.

¹⁸ Second Amendment §3(a)(ii).

¹⁹ Loan Agreement, p. 9.

Agreement, the issue of whether Sovereign was unjustly enriched by LEM's payment of post Maturity Date interest must be left for trial.

The terms of the Second Amendment are clear: LEM had no obligation to make additional interest payments after the Maturity Date. Therefore, Sovereign's Motion to Amend its Counterclaim to add a claim for breach of the Agreement based on LEM's failure to remit additional interest payments after October, 2008, must be denied.

VI. LEM Does Not Have To Purchase Sovereign's Participation Share.

Sovereign argues that LEM was obligated under the Second Amendment to purchase Sovereign's \$30 million Participation Share when LEM took title to the Property in April, 2008.

The Second Amendment provides as follows:

[C]ontemporaneously with the occurrence of a Title Event,²⁰ [LEM] shall be obligated to purchase from [Sovereign] [Sovereign's] Participation Share for a cash purchase price (the "Purchase Price") equal to the then outstanding principal amount of [Sovereign's] Participation Share, all accrued and unpaid interest thereon and all other sums due and owing to [Sovereign] in connection therewith. The sale and purchase of [Sovereign's] Participation Share shall occur as soon as reasonably practicable . . . provided, however, that purchase and sale shall only occur after the parties have negotiated and executed loan and assignment documents satisfactory to both of them.²¹

[C]ontemporaneously with [LEM taking title to the Property], at the request of [LEM] and subject to the terms and conditions set forth in Section 2(e) below, [Sovereign] shall, or shall cause an affiliated entity to, finance the cost of the Purchase Price by extending a Loan to [LEM] in the amount thereof, or such lesser amount as may be requested by [LEM] (the "Purchase Loan"). . . .²²

²⁰ A "Title Event" is defined as LEM "taking title to all or any portion of the Real Property, whether in its own name or through a related entity, and whether by deed-in-lieu of foreclosure, foreclosure or in any other manner." Second Amendment §2(a).

²¹ Second Amendment §2(b).

²² Second Amendment §2(d).

Notwithstanding anything in this Amendment to the contrary, if [Sovereign] fails to make the Purchase Loan, [LEM] shall not be obligated to make the purchase contemplated under this Section 2.²³

LEM claims it exercised its option not to purchase Sovereign's Participation Share. No such option is expressly set forth in the Second Amendment. However, the court cannot compel LEM to purchase Sovereign's Participation Share at this point. If the court were to do so, LEM would simply exercise its rights under the Second Amendment and demand that Sovereign give LEM a loan to finance the purchase.

Sovereign has expressed no interest in making such a loan, and it is extremely unlikely that Sovereign would do so given that: 1) the security for the loan, *i.e.*, the Property, has dramatically declined in value and is worth significantly less than the loan amount; 2) the parties can no longer work together amicably; and 3) the Second Amendment specifically contemplates that Sovereign may refuse to make the loan to LEM. Furthermore, the terms of the anticipated Purchase Loan set forth in the Second Amendment are not specific enough for the court to require Sovereign to make the loan to LEM.²⁴ Given that the necessary Purchase Loan is an impossibility at this point, the court cannot compel LEM to purchase Sovereign's Participation Share.

VII. LEM Must Transfer Title To The Property To Sovereign.

Sovereign claims that LEM must transfer title to the Property to Sovereign so that Sovereign can sell the Property and repay itself a portion of its Participation Share. LEM refuses to do so because it hopes that at some point in the future the Property will be worth more, perhaps even enough to repay both LEM's and Sovereign's Shares.

²³ Second Amendment §2(h).

²⁴ For instance, no loan term of years or months was set forth in the Second Amendment.

Sovereign relies upon the following provision of the Agreement as justification for the transfer of title:

Notwithstanding if (a) [LEM] fails to perform (i) its obligations under Section 3.2 above . . . or (c) there has been a material deterioration in the value of the Property . . . then in each such event, upon the written demand of [Sovereign], [LEM] shall turn over to, and shall assign, endorse, and transfer the Loan to [Sovereign] . . .²⁵

This provision says nothing about the transfer of title, nor does it speak to what happens if the Loan ceases to exist and is replaced by a Judgment as occurred in March, 2008. However, LEM may not hold title to the Property hostage forever.

Under the Agreement, upon foreclosure of the Property, Sovereign holds a majority interest in the Property:

If [LEM] acquires an ownership interest in the Property due to foreclosure . . . [Sovereign] shall have an undivided interest in such ownership interest equal to its fractional share [\approx 83%], notwithstanding the fact that title is taken in the name of [LEM] alone.²⁶

Absent language in the parties' Agreement to the contrary, Sovereign, as majority interest holder, may direct the disposition of the Property in which it holds an undivided majority interest.

Therefore, LEM must transfer title to the Property to Sovereign as Sovereign directs, so that Sovereign may sell the Property.

²⁵ Agreement § 4.4.

²⁶ Agreement §3.4.

CONCLUSION

For these reasons, the parties' cross-motions for summary judgment are granted, in part, and denied, in part.

An Order consistent with this Opinion will be issued.

BY THE COURT,

ALBERT W. SHEPPARD, JR., J.