UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF ILLINOIS
EASTERN DIVISION

UNITED STATES SECURITIES AND EXCHANGE COMMISSION, Plaintiff, v. EQUITYBUILD, INC., EQUITYBUILD FINANCE, LLC, JEROME H. COHEN, and SHAUN D. COHEN Defendants.	Case No. 1:18-cv-5587 Hon. John Z. Lee Magistrate Judge Young B. Kim

MOTION TO AMEND MAY 2, 2019 MEMORANDUM OPINION AND ORDER

The following mortgagees (collectively, "Movants", and each individually a "Mortgagee") respectfully file this motion ("Motion") requesting the Court amend its May 2, 2019 Memorandum Opinion and Order [Dkt. 352] ("May 2 Order"): (1) Citibank N.A., as Trustee for the Registered Holders of Wells Fargo Commercial Mortgage Securities, Inc., Multifamily Mortgage Pass-Through Certificates, Series 2018-SB48; (2) U.S. Bank National Association, as Trustee for the Registered Holders of J.P. Morgan Chase Commercial Mortgage Securities Corp., Multifamily Mortgage Pass-Through Certificates, Series 2017-SB30; (3) U.S. Bank National Association, as Trustee for the Registered Holders of J.P. Morgan Chase Commercial Mortgage Securities Corp., Multifamily Mortgage Pass-Through Certificates, Series 2017-SB41; (4) U.S. Bank National Association, as Trustee for the Registered Holders of J.P. Morgan Chase Commercial Mortgage Securities Corp., Multifamily Mortgage Pass-Through Certificates, Series 2018-SB50; (5) Wilmington Trust, National Association, as Trustee for the Registered Holders of Wells Fargo Commercial Mortgage Trust 2014-LC16, Commercial Mortgage Pass-Through Certificates, Series

2014-LC16; and (6) Federal National Mortgage Association ("Fannie Mae"). In support of the Motion, the Movants state as follows:

INTRODUCTION

The May 2 Order granted the Receiver's Second Motion for Court Approval of the Process for Public Sale of Real Property by Seal Bid and sustained objections by the Movants to segregate the sale proceeds and to allow the Movants to credit bid. The Movants greatly appreciate the Court's analysis and decision on both objections. Since entry of the May 2 Order, the Movants have worked with the Receiver to address issues the Movants have with the proposed credit bid process. On May 22, 2019, Magistrate Judge Kim entered an order in which the Court instructed the Movants to file a motion to amend the May 2 Order if by May 31, 2019 the Movants and the Receiver have not reached an agreement on the credit bid process. The parties have not reached resolution. The Movants respectfully request the Court amend the May 2 Order as provided herein.

ARGUMENT

The Movants respectfully request that the court amend the May 2 Order to conform to Illinois law. As this Court as properly held, neither it nor the Receiver has the authority to extinguish a creditor's pre-existing state law security interest. *See* Memorandum Report and Recommendation [Dkt. 311] (stating "a court does not have the authority to extinguish a creditor's pre-existing state law security interest" and clarifying the issue by stating "[t]o be sure, a receiver appointed by the federal court takes property subject to all liens, properties, or privileges existing or accruing under the laws of the state.") (internal citation omitted); *See also* Magistrate Kim's Memorandum Opinion and Order, pp. 9-10 [Dkt. 352] (reaffirming the foregoing rulings). In fact, the Court has already made rulings and determinations in furtherance of these well-established principles. *See United States v. EquityBuild, Inc.*, No. 18 CV 5587, 2019 WL 587414, *3 (N.D.

Ill. Feb. 13, 2019) (Magistrate Kim's Memorandum Opinion and Order [DKT. 223] (holding that the Receiver cannot commingle rents and the Receiver must separately account for the rents from each property); Memorandum Report and Recommendation [Dkt. 311] (holding that sale proceeds shall not be commingled and that the lender's security interest in the proceeds shall not be extinguished by sale of the property). Therefore, the Movants respectfully request this Court amend the May 2 Order to conform with and preserve the Movant's established security interests.

I. THE AMOUNT DUE EACH MORTGAGEE MUST BE DETERMINED BEFORE A MORTGAGEE CAN CREDIT BID.

Illinois law mandates that this Court first determine the amount owed each Mortgagee prior to proceeding with the credit bid process proposed in the May 2 Order. Under Illinois law, credit bidding allows a foreclosing lender to bid the amount of its debt to purchase the foreclosed property. *FDIC v. Chicago Title Ins. Co.*, No. 12-CV-05198, 2015 WL 5276346, at *4 (N.D. Ill. Sept. 9, 2015). Unlike a third party bidder, a lender is not required to pay cash. *Id.* The purposes of credit bidding is to avoid the inefficiencies of requiring a lender to tender cash that would immediately be returned back to the lender. *Id.*; *FDIC v. Meyer*, 781 F.2d 1260, 1265 (7th Cir. 1986). The right of a lender to credit bid is derived from the amount of the foreclosure judgment. A lender is entitled to credit bid up to the amount of its foreclosure judgment amount. *Meyer*, 781 F.2d at 1264-65 (stating "the judicial finding of the amount due determines the amount the foreclosing lender can credit bid"). Similarly, the judgment amount also sets the amount the foreclosing lender must pay in cash if its bid exceeds its judgment amount. *Meyer*, 781 F.2d at 1265. For instance, if the judgment amount is $1,000,000 but the lender bids $1,100,000, then the lender will have to pay $100,000 in cash.

The Receiver has indicated he will challenge the amounts due the Movants, including, but not limited to, default interest, attorneys' fees, and other fees and costs. The Movants are entitled

to, and indeed Illinois law requires, a determination on the amounts due the Movants prior to credit bidding. Without a determination of the amounts due, the Movants are required to blindly guess the credit bid maximum and at what amount they would be required to come out of pocket. This guessing game leaves the Movants exposed to substantial liability. Such an unjust outcome cannot be countenanced.

Indeed, such an outcome is completely inconsistent and antithetical to secured lenders' statutory lien rights under Illinois law, which requires first a judgment on the amount of a debt owed to the secured lender before a foreclosure sale or credit bid can even occur. Only when the judgment is entered setting an amount of the secured lender's debt may a sale go forward which would allow a secured lender to credit bid its known and court-approved debt. Here, no such debt has even been determined nor approved that would serve as a basis for the credit bid. This process is structured this way for a reason. To allow all parties in interest – even third party bidders – to have certainty as to the maximum amount of a credit bid. The Receiver's proposed process is clearly antithetical to the receiver "tak[ing] the property subject to all liens, properties, or privileges existing or accruing under the laws of the state."

The posting of a letter of credit does not resolve this issue. As an initial matter, some of the Movants may be precluded under their pooling and servicing agreements from obtaining a letter of credit. As such, lenders who have the statutory right to credit bid in a state law foreclosure – without the need of obtaining a letter of credit – are now prevented from exercising their statutory right to credit bidding because of the imposition of a letter of credit requirement.

Additionally, the posting of a letter of credit exposes lenders to an even greater risk by essentially requiring the lender to make two loans. In other words, as currently structured, a lender could be required to pay twice for the same loan, leaving the lender doubly exposed. For example,

the first loan is the original loan to the Equitybuild affiliate, which was done long before the receivership. The receiver does not contest that these loans were in fact given or that the lenders' loan proceeds were utilized by the borrowers.

The second loan is the posting of a letter of credit. By placing the cart before the proverbial horse on lien priority and debt amount, the receiver is forcing the lenders to assume the risk that their liens may be subordinated or even deemed unsecured and that they would be required to pay twice for a single property. Indeed, under the current process, this scenario could occur even before the receiver is even required to specify which liens are, in fact, contested. This would result in the lender extending two loans for the same property. Put simply, no homeowner would pay twice to buy the same house. Yet such a result would follow here. Such an outcome surely was not the intent of the court. Therefore, the Movants respectfully request the May 2 Order be amended to provide for a determination of the amounts due each Mortgagee prior to sale of any additional properties.

II. LIEN PRIORITY MUST BE DETERMINED TO EFFECTIVELY CONDUCT THE CREDIT BID PROCESS.

The court must determine priority of the Movants' liens and the Equitybuild investors' liens to effectively administer the credit bid process. Adjudication of priority status, similar to determination of the debt amount, is necessary because it identifies the priority structure, sets the limits of the senior lienholders credit bid amount, determines how much cash a junior lienholder must pay to eliminate a senior lienholder, and determines the amount a foreclosing lienholder must pay in cash if it bids more than its mortgage debt. *Meyer*, 781 F.2d at 1264-65.

Partel, Inc. v. Harris Trust and Sav. Bank, 106 Ill App. 3d 962 (1st Dist. 1982) illustrates this point. In *Partel*, three separate mortgagees each held a mortgage on the same piece of real estate. Their respective priorities and the amounts due each were determined in a consolidated

foreclosure action. *Id*. at 963. A public foreclosure sale was held and the second secured lienholder was the highest bidder. The second lienholder's bid consisted of the full amount of the senior lienholder's debt plus the second lienholder's adjudicated debt.[1] *Id*. at 964. The second lienholder obtained title to the property by buying out the senior lienholder and outbidding any other competing parties. *Id*.

The exact same principle applies here. The Receiver has taken the position that Equitybuild investors have prior secured positions on certain of the Movants' properties. The issue of priority must be determined first before the court can effectively administer a credit bid process. Without this information, the Movants cannot make an informed decision as to whether they must buy out a senior lienholder, the amount of their credit bid, and whether crediting bidding is in their best interest. *See Meyer*, 781 F. 2d at 1264-65. This process is utterly consistent with the lenders' statutory rights under Illinois law.

An example illustrates this point. Assume one property has a recorded Mortgagee mortgage with $2,000,000 outstanding on the note and that same property has an Equitybuild investors' mortgage with $1,000,000 outstanding. If the Mortgagee is deemed to have priority, it can credit bid up to the full amount of its debt ($2,000,000) without having to pay any cash. However, now assume the Equitybuild investors' mortgage has priority. If the Mortgagee wants to credit bid at the sale, it will have to pay the Equitybuild investors $1,000,000 to satisfy their prior secured lien and then the Mortgagee would be entitled to credit bid its remaining $2,000,000. If priority and lien amount are not adjudicated prior to the sale and the Mortgagee credit bids $1,500,000 based on the assumption it has a senior lien, and it is then determined at a later date the Equitybuild investors are senior with a $1,000,000 lien, then the Mortgagee would have to pay $1,000,000 in

[1] The second lienholder was not required to bid the full amount of its debt but did so for unknown reasons.

cash to satisfy the Equitybuild investors even though the Mortgagee made a business decision based on the assumption it would not have to pay any money out of pocket. Surely such an inequitable and legally incompatible outcome is not the intent of this Court. Therefore, the Movants request that the May 2 Order be amended to determine the priority of each Mortgagee's lien and the Equitybuild investors' liens prior to sale of any additional properties.

III. THE MOVANTS SHOULD NOT BE RESPONSIBLE FOR CLOSING COSTS.

The Movants should not be required to pay any costs other than the standard Illinois commercial foreclosure costs. The Receiver has taken the position that the Movants shall be required to pay, in cash, an array of closing costs in unspecified, undetermined, and open-ended amounts, including surveys, property management fees, escrow fees, brokerage commissions, title commitment update fees, gap insurance premiums, State of Illinois policy fees, extended coverage premiums, and the costs of closing protection coverage. Such fees and costs may be applicable in a standard arm's length commercial real estate sale, but are **not** applicable in the foreclosure and credit bid context.

The typical costs associated with a commercial foreclosure include publication costs and the selling agent's commission. Any other costs in a commercial foreclosure beyond publication and the selling agent's nominal commission is generally at the election of the lender. The sale commission is nominal. For instance, the commission due the Will County Sheriff is $600. Will County Sheriff, https://www.willcosheriff.org/foreclosures/index.php/attorneys/2-important-information (last visited June 4, 2019). Here, the Receiver intends to saddle the Movants with selling commissions that could approach $100,000. *See* Receiver's First Motion for Court Approval of the Sale of Certain Real Estate and for the Avoidance of Certain Mortgages, Liens, Claims, and Encumbrances, ¶ 40 [Dkt. 230]. This astronomical amount does not include other closings costs that could exceed another $100,000. *Id.*

Requiring the Movants to pay in cash an undisclosed amount of closing costs is entirely contrary to Illinois law. First, the Movants would be required to come out of pocket for these costs. As shown above, the only cash a lender must pay in a commercial foreclosure sale is to buy out a senior lienholder or the amount the lender bids above its judgment amount. Second, the Movants would be severally prejudiced by this scenario if the Movants are adjudicated to have senior liens on the properties. If the Movants are determined the have senior liens, then they would be entitled to conduct their own foreclosure, credit bid up to the full amount of their debt, and not come out of pocket for any substantial sale costs. Under the May 2 Order as written, the Movants may be adjudicated the senior lienholder and still have to pay potentially hundreds of thousands of dollars in unnecessary closing costs. The risk of this harm is too substantial to allow the May 2 Order to stand as written. Therefore, the Movants respectfully request that the May 2 Order be amended to eliminate any closing costs other than those associated with a standard Illinois commercial foreclosure.

IV. THE PROCESS SHOULD REQUIRE THAT THE SALE PRICE EXCEED THE DEBT OF THE DETERMINED SENIOR SECURED LENDER.

As noted, the foreclosing lender is entitled to either (a) be paid in full all of its indebtedness under the loan documents or (b) credit bid its judicially determined debt. In the event the Court cannot fashion a workable credit bid structure to accommodate the requirements of secured lenders under Illinois law regarding credit bidding, the Court should require that the sale process mandate that the floor price for the sale of the property exceed the value of the debt and that senior secured lenders be paid in full. State law does not permit a "discounted payoff" to secured lenders. Either the lender is paid in full or the lender is entitled to foreclose and credit bid its judicially determined debt.

As noted, previously, the lenders have suggested that a better and far more efficient use is to allow those properties without any equity above and beyond the secured debt, to be lifted from the stay and allowed to proceed to sale in foreclosure court as was done in the *Madison* SEC receivership case. *S.E.C. v. Madison Real Estate Grp., LLC*, 647 F. Supp. 2d 1271 (D. Utah 2009) To require this Court to adjudicate alleged disputes among secured creditors without any equity to be returned for the use of the administration of the estate and claimants is a misuse of the resources and provides a serious drain on all resources. Under a state law foreclosure scenario, no brokers are required and instead a sale is conducted by bidding, and those interested in bidding are welcome to do so. Also, in a state law foreclosure, any equity that exists if a lender's credit bid is out bid, is returned to the borrower. As such, to the extent a third party bidder would like to overbid a secured credit lender's bid, those funds would be returned to the receivership estate. This scenario provides a much more conclusive and well-established framework in specifically created foreclosure courts well-equipped with addressing lien priority disputes. To attempt to recreate this process under the auspices of an SEC receivership is a grave misuses of investor funds, estate assets, and judicial resources.

V. A MORTGAGEE SHOULD NOT BE REQUIRED TO TAKE TITLE.

The Movants respectfully request that the May 2 Order be modified to allow title to be taken in the name of an entity other than the individual Mortgagee. Specifically, the Movants request that the May 2 Order authorize title to be taken in the name of a special purpose entity. Similarly, the Movants request the right to assign the right to title pursuant to the credit bid to a third party, related or unrelated, prior to or in conjunction with any closing.

WHEREFORE, for each of the reasons asserted herein, the Movants respectfully request that this Court enter an order modifying its May 2, 2019 order as noted herein.

Dated: June 7, 2019

Respectfully submitted,

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