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IN THE SUPREME COURT OF THE STATE OF DELAWARE

PVP ASTON, LLC, *et al*., Appellants, Plaintiffs Below, v. US BANK NATIONAL ASSOCIATION, *et al*., Appellees, Defendants Below.	C.A. No. 67,2023 On appeal from the Superior Court of the State of Delaware, Case No. N22C-03-103 AML (CCLD)

APPELLANTS' REPLY BRIEF

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PRELIMINARY STATEMENT

This appeal concerns the Superior Court's construction of loan agreements and financial insurance policies relating to a series of realty sale-leaseback transactions. If permitted to stand, the Defendants' challenged conduct and the Superior Court's decision to validate that conduct will deprive the Plaintiffs of millions of dollars in equity that they have built over more than 20 years as the owners of the Properties.

The Lenders under the loan agreements, the Defendants here, were contractually bound to the provisions of the loan documents and – like any other lender – had certain obligations to their borrowers, the Plaintiffs here. The Lenders also were bound to the provisions of the insurance documents under which they were beneficiaries. Under the circumstances of this case, when the Loans matured and were paid, the Defendants could have and should have complied with both sets of agreements in accordance with their terms. However, for reasons unknown to the Plaintiffs, the Defendants ignored their very clear obligations to the Plaintiffs under the loan agreements and rendered "performance" only to the insurer under the insurance agreements, all at the expense of the Plaintiffs. These actions were taken knowingly and intentionally by the Defendants, even though there is no document anywhere that purported to relieve them of their clear obligations to the Plaintiffs.

As discussed in the Plaintiffs' Opening Brief, the Superior Court committed reversible error by failing to give effect to the plain language of the loan agreements, terms that required the Defendants to apply the insurance proceeds that they received to the outstanding debt obligations of the Plaintiffs. In their Answering Brief,[1] the Defendants fail to explain why that unambiguous and plain language should be ignored. Instead, Defendants make outcome-oriented arguments wholly unsupported by the actual language of the contracts. Defendants also attempt to avoid culpability for their own conduct and argue that their only duty was to assign the Loan Documents to FSL, the financial guaranty insurer. Defendants argue they had no obligations under the Loan Documents to Plaintiffs.

The Defendants present this Court with their theory of the case, but that theory (i) ignores the averments in the Complaint about Defendants' conduct (which must be taken as true at the pleading stage), (ii) ignores plain language of the Loan Documents at issue in this appeal; and (iii) misconstrues or ignores provisions of the insurance documents. Plaintiffs' contentions in the Superior Court, and now on appeal, hinge on their right to enforce the Loan Documents as drafted, and that the Defendants were not free to rewrite the Loan Documents and accept payments to satisfy the loans but then cut new deals to facilitate transfers of the loan documents evidencing (falsely) that payments had never been made.

[1] Cited herein as Ans. Br. at __.

In apparent recognition of the weakness of their position, the Defendants then urge this Court to affirm the judgment of the Superior Court on grounds that the Superior Court did not consider.

All of these arguments fail and the judgment of the Superior Court must be reversed.

I. The Plain Language of the Loan Documents Required Application of the FSL Policy Proceeds to the Borrowers' Outstanding Obligations.

A. The RA2 Set of Loan Documents.

As discussed in the Plaintiffs' Opening Brief (Op. Br. at 8-10), the Loan Documents under consideration in this case fall into two subsets, the RA2 Set and the WEC Set, that are substantively identical within each set. The vast majority of the Loan Documents at issue are contained in the RA2 Set.

The language in the RA2 Set of Loan Documents that addresses application of proceeds following a default could not be clearer: the Lender is required to apply "all moneys received" to the borrower's [Plaintiffs'] outstanding obligations after reimbursement of the Lenders' unpaid expenses.[2] The Defendants seek to avoid this

[2] Section 6.05 of the RA2 Set provides:

> *Payments after Event of Default.* The Lender shall apply (a) **all moneys received and amounts realized by it** (including any amounts realized by the Lender pursuant to the exercise of remedies pursuant to this Agreement, the Mortgage, the Lease Assignment, Paragraph 19 of the Lease or any other Operative Document) after … the principal of the Loan then Outstanding shall have been declared to be due and payable immediately pursuant to Section 7.01, and (b) all moneys then held or thereafter received by it under this Agreement or under any other Operative Document as part of the Mortgaged Property, as follows:
>
> > (i) to reimburse the Lender for any unpaid expense (including any reasonable legal and other professional fees or expenses) or other costs incurred or paid or advances made by it with its own funds;

plain language and their resulting obligations by making a series of specious arguments. None of those arguments overcomes the unambiguous language of the Loan Documents.

First, the Defendants argue that the obligation to apply the funds that they received as required in the Loan Documents was never triggered because their supposed obligation to assign the Loan Documents to FSL came first. (Ans. Br. 20-21). In other words, according to Defendants, upon receipt of the FSL Policy proceeds, their first (and apparently only) obligation was to assign the Loan Documents to FSL. They were then, according to them, freed of any other obligations under the Loan Documents. Tellingly, the Defendants have not cited any language in the contract that i) permits them to accept payments without applying those payments to the outstanding balances due, or ii) requires this order of operation: because there is none. The Defendants actually could have satisfied both of these duties by applying the Policy proceeds as required by the Loan Documents and then making the assignment of those documents to FSL. That course of conduct would have given meaning to all of the terms of their agreements rather than elevating the assignment to FSL as the first, and only, order of business.

> (ii) **to pay in full the aggregate unpaid principal amount of the Loan then Outstanding,** plus any due but unpaid interest thereon to the date of application ….

(A495) (emphasis added).

The Defendants next argue that the Plaintiffs' beef is not with the Defendants but with FSL or its designees as the new holders of the Loan Documents following assignment. (Ans. Br. 21). But the Plaintiffs' claims in this case relate to the **Defendants' conduct** when they held the Loans, not FSL's conduct following the assignments. The Complaint in this action asserts that, by accepting payments on the outstanding loan amounts, treating the loans internally (and secretly) on their own books as satisfied, but then assigning the documents evidencing unsatisfied obligations, the Defendants breached their obligations under the Loan Documents. (A45, ¶ 74). Moreover, it is the Defendants who received the Policy proceeds, not FSL or any other party. A claim for the misapplication of the proceeds that the Lenders received could not logically lie against any other party.

The Defendants next attempt to make the argument that the Loan Documents do not say what they actually say. As mentioned, Section 6.05 of the RA2 Set requires the Lenders to apply "all moneys received and amounts realized" to the borrowers' outstanding obligations. But the Defendants claim:

- That "all moneys received and amounts realized by" the Lender does not mean what it says. (Ans. Br. 24).
- That the parenthetical phrase following "all moneys received and amounts realized," – *i.e.,* "(including any amounts realized by the Lender pursuant to the exercise of remedies pursuant to this Agreement,

the Mortgage, the Lease Assignment, Paragraph 19 of the Lease or any other Operative Document)" – is a limitation on rather than a description of "all moneys received." (Ans. Br. 24-25).

- That the word "including" does not mean "including" but rather means excluding anything not listed. Defendants make this remarkable argument in the face of the rule of construction contained in Loan Documents themselves providing that the word "including" "shall be deemed to be followed by the words 'without limitation.'" (AR1).

Next, the Defendants make a cagey, if not disingenuous, argument that they know is contradicted by the facts. They argue that Section 6.05 is only triggered after the Lender declares the Loan to be due and payable under Section 7.01 of the Loan Agreement. (Ans. Br. at 25-26). They then argue that the Plaintiffs never **pled** that the Lenders made that declaration.[3] Notably, the Defendants never claim that they did not accelerate the Loans, because that would be false. The Defendants sent notices declaring the Loans due and payable that specifically cite Section 7.01 of the

[3] The Defendants argued "there is no allegation that the Lender exercised its right under Section 7.01 to 'at anytime [after an Event of Default] at its option by written notice to [Borrower] declare the Loan to be due and payable.'" (Ans. Br. 26).

Loan Documents. (AR 11).[4] The bottom line is the Lenders did accelerate the loans under Section 7.01, and they know it.

Slyly, the Lenders have technically not argued that Section 6.05 was not triggered. They argued only that the Plaintiffs did not specifically plead that fact. But the Plaintiffs only obligation was to give the Defendants notice of the claims, not to file a summary judgment brief disguised as a complaint. *Precision Air, Inc. v. Standard Chlorine, Inc.*, 654 A.2d 403, 406 (Del. 1995).

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[4] Specifically, in the U.S. Bank Default Letter, the Defendant wrote:

> Lender notified Borrower in that certain notice dated and received September 2, 2020 (the "**Notice**") that (i) as of September 1, 2020, Borrower had failed to pay the principal amount of the Loan then Outstanding . . . and (ii) pursuant to Section 7.01(a) of the Loan Agreement, Borrower's failure to cure the Maturity Default within three (3) Business Days from the date the Notice was given shall be an Event of Default under the Loan Agreement.
>
> As of the date hereof, Borrower has failed to cure the Maturity Default. **Such failure is an Event of Default entitling the Lender to exercise all of its rights and remedies under the Loan Documents and at law, in equity or otherwise.**

(emphasis in original).

These documents were not in the record before the Superior Court, although counsel advised the Court of their existence during oral argument. (A405, Oral Arg. Trans. pp. 52-53). They are offered here solely to demonstrate that an assertion of fact that the Defendants have made would actually be disproved once this case is permitted to proceed to discovery and trial.

The Lenders' argument here supports reversal and remand, as it shows the danger and harm to the Plaintiffs of dismissing a claim on the pleadings, before any discovery is conducted. The Lenders' arguments do not match their actual conduct (as alleged in the Complaint). Had this case been permitted to proceed, Plaintiffs would have had to opportunity to prove exactly what the Lenders did here, how they reflected payments on their books internally as evidence of satisfied loans, but then assigned documents showing loan balances due, and how their conduct ran afoul of the Loan Documents, and their obligations to the Plaintiffs. These facts would show that the Defendants intended the policy proceeds to be loan payoffs, not gifts or gratuitous payments from FSL.

B. The WEC Set of Loan Documents.

The Loan Documents in the WEC Set, while not identical, yield the same result. The relevant language in the WEC Set reads:

> If following the occurrence of any Event of Default under this Indenture, Grantor [Borrower] shall tender payment of an amount sufficient to satisfy the Debt at any time prior to a sale of the Mortgaged Property either through foreclosure or the exercise of other remedies available to Beneficiary [Lender] under this Indenture, such tender by Grantor [Borrower] shall be deemed to be a voluntary prepayment under the Note and this Indenture in the amount tendered.

(A538-39). The Lenders on these Loans received funds from FSL sufficient to satisfy the Debt prior to a foreclosure sale and prior to the Lender exercising other remedies. The only substantive argument that the Defendants make is that the tender

of payment, they claim, was not made by the Borrower. (Ans. Br. 23). Because the Borrower paid for the RVI policy and the proceeds from that policy paid the outstanding balance, a reasonable interpretation of this language is that the borrower made the tender.

For example, if a company other than the borrower (perhaps a related entity), wrote the check to pay off the balance of the loan on behalf of the borrower, it would be unreasonable to suggest that the borrower did not "tender" payment. Similarly, here, when an insurance policy that the borrower procured made the necessary payment, that payment constitutes a tender of payment by the borrower. In any event, at the pleadings stage when all reasonable inferences must be made in their favor, the Plaintiffs are entitled to the inference that the insurance proceeds were tendered by the Borrowers. *Cent. Mortgage Co. v. Morgan Stanley Mortgage Capital Holdings, LLC*, 27 A.3d 531, 535 (Del. 2011).

The Defendants then argue, without citation to the language of the Loan Documents, that this provision only applies to a default that occurs "before maturity" of the Loan. (Ans. Br. 23). Putting aside the fact that there is nothing in the cited language that supports this position, the actual language of the provision requires the opposite conclusion. The very first words of the default provision read, "If following the occurrence of **any Event of Default** . . ." It does not read, as Defendants suggest, "any Event of Default before maturity." In addition, the WEC Set of Loan

Documents helpfully clarifies that an "Event of Default" occurs "**if any portion of the Debt is not paid when due**, whether at the due date thereof or at the date fixed for prepayment or acceleration or otherwise." (A535) (emphasis added).

In sum, the arguments that the Defendants make in order to avoid the plain language of the Loan Documents do not countenance affirming the Superior Court's judgment.

II. The Defendants Successfully Destroy Their Own Strawman Regarding Their Right to Assign the Loan Documents

The Defendants' next argument is based upon a mischaracterization of the Plaintiffs' case. Defendants write in their brief: "Borrowers' entire theory of liability is based on the premise that Lenders had no right to assign the Loan Documents to FSL . . . ." (Ans. Br. at 28). Having built their strawman, Defendants then proceed to dismantle it. They cite cases on the free assignability of contracts and the language of the Loan Documents, the Policies, and the ANIE to demonstrate the plain error in this position upon which the Plaintiffs purportedly based their "entire theory of liability." Unfortunately for the Defendants, Plaintiffs never made this claim in their Amended Complaint nor made this argument in the Superior Court or before this Court.

In the Amended Complaint, the Plaintiffs made the following allegations:

- Under the circumstances that existed when claims were paid in this case and by reason of elections made by FSL itself, upon payment of the "Insured Value" set forth in the applicable Policy, ***the applicable Lender should have realized a zero balance on the applicable Loan and characterized the applicable Loan as satisfied on behalf of the Insured pursuant to the provisions of the Policy***. (A37, ¶39) (emphasis added);

- The zero balance should have been indicated in any assignment or allonge that was delivered to FSL ***but the same was intentionally omitted***. (A37, ¶40) (emphasis added);

- [E]ach of the Loans was assigned by the applicable Defendant, pursuant to instruments ***that purposefully omitted the actual balance of the Loan***, thereby breaching the applicable loan documents and the

obligations of the Lender to the Insured pursuant to the applicable Policy. (A38, ¶41) (emphasis added);

- Failure to refuse to deliver such documents [the assignments], or to cause such documents to evidence that, at the time of assignment of each Loan, the outstanding balance was zero, was a material breach by each Defendant of its obligations under the Loan Documents, its duties of good faith and fair dealing (i) to the borrowers under the applicable Loan Documents and (ii) to the Insureds under the applicable Policies. (A45, ¶74)

- Under the Loan Documents, upon receipt of claim funds in a case where the Loan Purchase Option was not exercised, Defendants had an obligation to regard the funds as the payoff of the Loan on behalf of the applicable Plaintiff. ***Defendants did apply the funds in that manner but purposefully breached the Loan Documents by delivering assignments that did not reflect a zero balance***. (A49, ¶94) (emphasis added).

Nowhere in the Amended Complaint is there an allegation that the Lenders had no right to assign the Loan Documents to FSL. What the Plaintiffs did argue in the Superior Court, and do argue in this Court,[5] is that, under the plain language of the

[5] *See* Opening Brief at 29-30 (emphasis in original):

> [T]he Lenders could have complied with their obligations under both the Base Policy and the ANIE by simply following the plain language of the agreements and not "reading into" the language of the ANIE meaning that was not there. Read strictly and without invented embellishment, the ANIE says only that, after a claim is paid, the *Loan Documents* must be assigned to FSL. That is all it says. It does not say that the proceeds of the claim cannot first be applied to reduce or pay off Loans as contemplated in the Loan Documents. It does not say that the assignment to which FSL is entitled shall be identical to the one contemplated under the Loan Purchase Option. It does not specify the amount of the Loan, if any, that must be reflected in the assignments. Put differently, to comply with the ANIE, the Lenders were not required

Loan Documents, the Lenders had an obligation to apply the Policy proceeds to the outstanding indebtedness prior to any assignment, and in fact, did so internally.

The Defendants next parrot the Superior Court's opinion that Plaintiffs' interpretation of the contract documents leads to a commercially and economically unreasonable result. (Ans. Br. at 35). But, as noted in Plaintiff Opening Brief (Op. Br. at 31-32), this argument ignores the allegations in the Amended Complaint, including the fact that the Plaintiffs expected that FSL would actually exercise the Loan Purchase Option upon payment of claims under the Policies.[6] With that expectation, Plaintiffs had every incentive to refinance and pay off the Loans when due. Only a global pandemic prevented them from doing so.

The Defendants attempt to support their economic irrationality argument by citing the decision of the Michigan court in *RA2 Troy, LLC v. FI 135 Troy, LLC* (found at AA146). In *RA2 Troy*, the Michigan Court considered whether an assignee of the Lender could exercise rights under the Policies and the related Insured Covenants Agreement. While the Plaintiffs believe that the Michigan court erred in its analysis of the documents and have taken an appeal of that decision, the important

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> to assign **unpaid loans**—they were required only to assign the *Loan Documents evidencing whatever rights existed thereunder at the time of delivery of the assignment.*

[6] It is also based on a clear misreading of the Policy language, which is detailed in the Opening Brief. *See* Op. Br. at 25-26.

point for present purposes is that the Michigan court never considered the actual language of the Loan Documents that required the Lenders to apply the Policy proceeds to the outstanding indebtedness. The court's conclusion was only that the **Policies** did not say that the proceeds would be applied to the loan balances. It never even considered the language of the Loan Documents. Of course, there was no reason for the Michigan court to consider that language because the defendant in *RA2 Troy* never received those proceeds. The defendant there was merely a downstream purchaser of the Loan Documents that took its interest without any representation or warranty concerning the validity or amount of the loan, and no estoppel or other assurance that, in fact, there was any balance remaining on the loan. Unlike Defendants here, it had no obligation to apply the insurance proceeds under Section 6.05 or the RA2 Set or Paragraph 25 of the WEC Set. Accordingly, the court looked no further than the Policy and never addressed the language of the Loan Documents.

The Superior Court decided, in the face of clear contract language to the contrary, that the Loan Documents did not require application of the proceeds of the Policies to the Borrower's outstanding indebtedness. That decision was error and should be reversed.

III. Plaintiffs Have Standing to Assert Breaches of the Policies.

By arguing that the Plaintiffs lack standing to assert the Defendants' breaches of the Policies, both the Defendants and the Superior Court misconstrue the terms of the Policies. Both cite the language that the Plaintiffs have no "ownership interest or other rights with respect to the proceeds of this Policy" to argue that Plaintiffs cannot seek to enforce the other provisions of the Policy that are to their benefit. They use this argument to claim that the Plaintiffs have no standing to complain about the fact that FSL did not pay the Lenders' claims in accordance with the Policies and that that failure caused the Plaintiffs to incur additional interest expense.

First, to be clear, the Plaintiffs have never argued that they have an interest in the proceeds of the Policies. But that fact does not mean that they have no other rights under the Policies. While the Plaintiffs' rights under the Policies are admittedly limited, one of those rights – the right to have FSL pay claims as required by the Policies – is expressly reserved.[7] Article V(a) of the Policies provides in

[7] The Insureds actually had numerous rights under the Policies, both explicit and implied, including (i) to consent or not to **any** amendment or waiver (Article VIII(e)); to participate and force the conduct of procedures to evaluate the condition and value of each insured property (Article IV); to select appraisers and other experts to give evidence as to matters covered in the Policies (Articles II and IV); to receive copies of all notices (Article VIII(b)); to assign "**its rights"** under the policies (Article VIII(d)); to enforce FSL's obligations not to cancel the policy (Article VIII(d)); and to prevent the transfer of certain subrogation rights (Article VIII(e)). They also, as named parties to a contract had the benefit of the covenant of good faith and fair dealing by the Defendants, which was breached when the Defendants

pertinent part, "the Company [FSL] shall have no liability to the Insured [Plaintiffs] **except to make payment to the Additional Named Insured in accordance with this Policy**." (A426) (emphasis added).

FSL did not, in fact, make payment to the Lenders in accordance with the Policies. FSL and the Defendants entered into the Extension Agreements under which FSL paid the Extension Fees in exchange for a delay in its obligation to pay the claims. Those Extension Fees were then treated by the Lenders and FSL as default interest on the Loans to the detriment of the Plaintiffs. (A39, ¶45). The Extension Agreements and Extension Fees also violated Article VIII(e) of the Policies that required the Plaintiffs' consent to any amendment to the Policies. (A83).

In sum, the Plaintiffs were damaged by the Defendants breaches of the Policies arising from the Extension Agreements and the Extension Fees. Plaintiffs have standing to seek redress for these breaches and the grievous consequences of them.

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failed to disclose unauthorized amendments to the Policies, did not provide applicable notices and assigned the fully paid off loans with balances shown thereon.

IV. The Plaintiffs Claims Are Not Barred by Collateral Estoppel.

Although the Superior Court did not address their collateral estoppel arguments, the Defendants raise collateral estoppel as an alternative basis upon which this Court should affirm the judgment of the Superior Court. The elements of collateral estoppel are simply not met in this case.

Among its other elements, collateral estoppel will only apply when "the issue previously decided is identical with the one presented in the action in question." *Troy Corp. v. Schoon*, 959 A.2d 1130, 1134 (Del. Ch. 2008) (citing *Capano v. State*, 889 A.2d 968, 985-86 (Del. 2006)). None of the previously decided cases that the Defendants cite – the Michigan case, the Idaho case, or the FSL Superior Court judgment – decided the issue presented here: whether the Lenders breached the Loan Documents by failing to apply the Policy proceeds to the borrowers' outstanding indebtedness. The provisions of the Loan Documents relevant here, Section 6.05 of the RA2 Set and Paragraph 25 of the WEC Set, are not even mentioned, let alone discussed in any of cases that Defendants raise for collateral estoppel purposes. Thus, the Defendants have failed to meet their burden to show that the issue before this Court was already decided by another tribunal. *Troy Corp.*, 959 A.2d at 1134 ("The party asserting collateral estoppel has the burden of showing that the issue was already decided in the first proceeding.").

More fundamentally, collateral estoppel prevents a party from relitigating **facts** that have already been decided by a prior finder of fact. In none of the cases to which the Defendants point did the Court make findings of fact. In order for collateral estoppel (as opposed to *res judicata*) to apply in subsequent litigation, it is the prior tribunal's findings of fact that are subsequently binding. Here, in none of the prior cases did the Courts make findings of fact. Both the Michigan Court and the Idaho Court made rulings on summary judgment as a matter of law. The Superior Court in the FSL case made its ruling on a motion to dismiss as a matter of law. Accordingly, there are no factual findings from those Courts that are binding on the Plaintiffs in this litigation. In addition, those cases did not involve the Lenders or their breaches of the Loan Documents as alleged in the Amended Complaint.

In sum, collateral estoppel does not provide an alternative basis to affirm the erroneous judgment of the Superior Court.

CONCLUSION

For the reasons set forth herein and in their Opening Brief, Plaintiffs respectfully request that the Court reverse the judgment of the Superior Court.

Dated: May 25, 2023

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CERTIFICATE OF SERVICE

I, Michael L. Vild, hereby certify that on this 25th day of May, 2023, I caused a true and correct copy of *Appellants' Reply Brief* to be served on the persons listed below via File & ServeXpress.

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