UNITED STATES BANKRUPTCY COURT

SOUTHERN DISTRICT OF NEW YORK

Case No. 22-11509-pb

- x

In the Matter of:

URBAN COMMONS 2 WEST LLC,

Debtor.

- x

The following constitutes the Court's modified bench ruling on the motion of the Residential Board, the Commercial Board and the Condominium Board of Managers for judicial review of the appraisal that was recently performed to determine the fair market value of the land underlying the Debtors' hotel for the purpose of re-setting the ground lease rent.

This modified ruling revises my April 21, 2023 bench ruling not only to correct transcription errors but also to make the ruling clearer and more readable. The substance of the decision has not changed. Due to its origins as a bench ruling, this decision is more colloquial and immediate in style than a formal written decision.

Date: New York, New York
May 25, 2023

/s/ Philip Bentley
United States Bankruptcy Judge

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MODIFIED BENCH RULING ON MOTION FOR JUDICIAL REVIEW OF APPRAISAL

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THE COURT: I'm ruling from the bench on the motion of the three parties that call themselves collectively "the Boards" — specifically, the Residential Board, the Commercial Board and the Condominium Board of Managers of the Millennium Point Condominium — for judicial review of the appraisal that determined the fair market value of the land on which the hotel that the Debtors own sits.

I'm ruling from the bench today because it's clear that the parties need a prompt ruling in order for the sale process for the hotel to move forward without delay. As I often do, I may subsequently issue a written decision that clarifies and perhaps expands on my bench ruling in minor respects, but which will not change the substance of today's ruling.

The dispute before me is over the resetting of ground rent — that is, the rent the Debtors owe as tenants under their ground lease with Battery Park City Authority ("BPCA"), the public authority that owns and manages Battery Park City. I'm going to give some details in a moment about that ground lease and how it relates to some of the other key documents in this case, but first, let me step back and give a slightly broader context.

Some of the issues in the dispute now before me are complicated because the legal structure governing the

building of which the Debtor's hotel is a part is complicated. As I mentioned, the building is built on ground-leased land. The building is a mixed-use condominium. It's a condo with two principal subunits, one referred to as the residential unit, the other referred to as the commercial unit, and the commercial unit in turn is subdivided into subunits, one of which is the hotel unit. The residential unit is subdivided into the units for the various residents who live in the building.

Because of the complexity of this structure, the rights of the building's occupants — the residents, the hotel and the Skyscraper Museum — are governed by a number of legal documents. There's the ground lease between BPCA and the building that I mentioned. There are also a set of design guidelines, a condo declaration and condo bylaws, and deeds for the various condo units in the building. There is also a master lease, which BPCA entered into with another New York State entity in or around 1980, about 20 years before the other governing documents were executed. How these various documents fit together and interrelate is at the heart of the parties' dispute over the rent reset and appraisal process.

BPCA, as the owner of the land, entered into the ground lease in or about 2000 for a term of about seven decades. As is common with ground leases, the lease set an

initial rent subject to periodic resets, the first reset having been originally scheduled for January 2022, a little more than a year ago. For a variety of reasons, the reset didn't happen then. It got delayed until the parties turned to it a few months ago.

As is typical, the ground lease provides a procedure for resetting the ground rent. In a nutshell, the procedure calls for each party to hire its own appraiser — the two parties being BPCA on the one hand and the three Boards on the other hand. If after conducting their own party appraisals, the parties can't agree on the value, the ground lease provides that the two appraisers then try to jointly agree on a third appraiser, a neutral, and the value of the land for rent reset purposes is then determined by majority vote of the three appraisers. The rent is then set as a percentage of the appraised value.

This process essentially leaves the final decision to the neutral appraiser, subject to potential input from whichever party appraiser chooses to join with him. For simplicity's sake, I'm going to refer to the appraisal that's being challenged as one done by "the appraiser," by which I mean the neutral appraiser, even though I know technically the appraisal was signed by the neutral plus BPCA's party appraiser.

The dispute in this case is over the ground lease

provision specifying the key assumptions to be used in these appraisals. Ground lease reset provisions vary in the assumptions they require. For example, some ground leases provide for the land to be valued as if it was unimproved, vacant, and unencumbered — that is, subject to the highest and best use. Other ground leases require different assumptions. For example, some require the land to be valued based on whatever buildings or other improvements have been constructed on the land — "as is," rather than "as if vacant and unimproved." Other ground leases require the land to be valued subject to certain encumbrances — for example, encumbrances contained in the ground lease, or encumbrances created by operation of law, such as zoning laws or landmark designation laws.

In this case, the governing provision of the ground lease provides that the appraiser shall value the land "as unencumbered by this lease and the master lease and unimproved." The parties have no disagreement about the meaning of the word "unimproved." They agree it means the land should be valued as if it were vacant.

What the parties disagree about is whether, in valuing the land, the appraiser should assume it is subject to any encumbrances — specially, any development restrictions. BPCA's position is that it should not. It argues that the words "unencumbered by this lease and the

master lease" mean unencumbered by any contractual development restrictions. (No-one claims there are any statutory or regulatory development restrictions.)

The Boards disagree. They argue that the governing provision here excludes consideration only of the ground lease and the master lease, and not of the other governing documents — namely, the design guidelines, the condo declaration and bylaws, and the deeds for the various condo units. Moreover, those other documents (like the ground lease and master lease) provide that the land will be developed as a mixed-use project, with a hotel as well as residential units. As a result, the Boards argue, the appraiser must value the land as if it was subject to that requirement, which I'll refer to as the "mixed-use development requirement."

In support of this argument, the Boards point to New York case law holding that provisions of this sort, specifying the encumbrances that an appraiser should or should not consider when valuing real property, must be narrowly construed. Here, because the governing provision specifically excludes consideration of the encumbrances contained in the two leases but makes no mention of the encumbrances contained in the other governing documents, the Boards contend the appraiser should have valued the land as subject to the latter encumbrances.

The parties here followed the appraisal process required by the ground lease, with each party appraiser conducting its own appraisal, after which a jointly-selected neutral appraiser conducted an appraisal. Both BPCA's appraiser and the neutral appraiser valued the land as if it were unencumbered, and the Boards' appraiser valued the land as subject to the mixed-use development requirement. All three appraisers concluded that the land would be worth vastly more if it were developed as a purely residential building than it is worth in its current use, as a mixed-use building containing a hotel as well as residential units. Consequently, based on the different encumbrance assumptions they used, the appraisals conducted by BPCA's appraiser and the neutral each attributed a value to the land more than triple the $50 million value determined by the Boards' appraisal.

The Boards argue that the neutral appraiser should have valued the land as subject to the mixed-use development restriction, rather than as subject to no development restrictions. They ask the Court to overturn his appraisal on the basis of this supposed error.

The record before me is purely documentary. The two sides each annexed a number of documents to their briefs. There's no dispute among the parties as to the admissibility of any of these documents or the propriety of

my considering any of these documents in connection with this motion. In addition, none of the parties asked to present testimony, so I'm basing my ruling on the briefs and on the various documents that have been annexed to the parties' motion papers.

The threshold issue before me is, what standard of review am I required to apply in reviewing the neutral appraiser's appraisal? I find that the grounds on which a court may overturn an appraisal are very limited under New York law, which the parties agree governs. I also find that the very limited grounds for overturning an appraisal have not been met in this case. On that basis, I'm going to deny the motion.

At bottom, I agree with BPCA's contention that the black letter standard under New York law for judicial review of an appraisal is that the Court is permitted to overturn an appraisal only in extremely limited circumstances, such as when fraud, bias, or bad faith has been shown. The Boards do not contend that any fraud, bias, or bad faith exists here on the part of the neutral appraiser. Instead their argument is that I have the power to overturn the appraisal on other grounds. They've advanced a variety of grounds that they say warrant reversal, and I will walk through those in turn in a moment.

As a preliminary matter, my task as a federal

judge applying New York law is to determine how the New York courts would decide the issue before me — namely, the standard of review. As a first step, I'm required to look to decisions by New York's highest court. If those decisions don't clearly resolve the issue, I'm required to look at the lower court decisions and try to predict how New York's highest court would rule if it was presented with the issue. See, e.g., Chufen Chen v. Dunkin' Brands, Inc., 954 F.3d 492, 497 (2d Cir. 2020).

Following this approach, the starting point for my analysis is the one Court of Appeals decision that's most closely on point, the decision in In re Penn Central, 56 N.Y.2d 120 (1982). That decision arose in a suit brought by Penn Central seeking to confirm an appraisal made by a panel of three appraisers pursuant to an agreement between Penn Central and Conrail. The dispute involved a parcel of land as to which Conrail owned the surface rights and Penn Central owned the air rights above the land. The parties had sold their combined fee interest to a third party and submitted the question of the allocation of the purchase price to the panel of three appraisers.

The appraisers allocated the price 65 percent to Penn Central for its air rights and 35 percent to Conrail for its surface rights. Conrail refused to accept this conclusion and refused to direct the escrow agent to release

the sale proceeds in accordance with the allocation.

Penn Central commenced a proceeding to have the appraisal confirmed. Ultimately, the case reached the Court of Appeals and the court confirmed the appraisal. The Court of Appeals rejected a variety of objections that Conrail advanced, including claims that are somewhat similar, at least in tone, to some of the Boards' arguments here — arguments that the appraisal was "patently defective" and that enforcing the appraisal "would be a gross travesty of justice." Strong claims, all of them rejected by the Court of Appeals.

What's most relevant here is the standard the Court of Appeals applied in deciding to reject these arguments by Conrail. The court held, "As a general rule under CPLR 7601, a dissatisfied party who participated in the selection of an independent appraiser has no greater right to challenge the appraiser's valuation than he would have to attack an award rendered by an arbitrator." 56 N.Y. 2d at 131.

The Boards don't dispute that the standard applied in reviewing an arbitrator's award is extremely limited. As a general matter, courts follow the standard I mentioned earlier — that is, that the award can only be overturned on a finding of "fraud, bias, or bad faith." That's a quotation from a First Department case, 936 Second Avenue L.P. v.

Second Corp. Development, 82 A.D.3d 446 (1st Dept 2011). And in that case, notably, the Appellate Division applied that general standard of arbitration award review to a case that sought review of an appraisal. That is, the First Department not only confirmed that that very limited standard governs in review of arbitration awards; it also extended the standard to appraisals, as the Court of Appeals had done in the Penn Central case.

Another relevant case is Wien & Malkin LLP v. Helmsley-Spear, 6 N.Y.3d 471 (2006). That's a Court of Appeals case holding that an arbitration award must be upheld even if the arbitrator has made errors of law or errors of fact.

Lower courts in New York have by and large followed the rule adopted by the New York Court of Appeals in Penn Central. I just cited the First Department's decision in 936 Second Avenue. For a few further examples, see Vitale v. Friedman, 227 A.D.2d 198 (1st Dept 1996), and 101 West 23 Owner I LLC v. 715-723 Sixth Avenue Owners Corp., 174 A.D.3d 447 (1st Dept 2019).

I say New York’s lower courts have “by and large” followed this standard, because I understand there may be a small number of courts that have applied a more relaxed standard of review. I'm aware of only one such decision, by a New York State trial court. When I'm faced with a conflict

of that sort — where the New York Court of Appeals and a number of Appellate Division cases have come out one way and one, or at most a few, trial court cases have come out the other way — then, obviously, there can be no real debate over which rule I'm required to follow.

The Boards don't dispute that the standards I mentioned do apply to review of arbitration awards, and as I mentioned earlier, they don't claim they can meet those stringent standards. Instead, their principal argument is that those standards of review apply only to arbitrations, and not also to appraisals. However, the Boards do not point to any New York State court decisions that are contrary to the rule I'm applying today.

Two of the three principal cases they rely on are federal district court decisions which in my view are completely unpersuasive as authority for New York State law on this issue. The first case they rely on is a more than 50-year-old decision of the District Court for the Southern District of New York, Clark v. Kraftco Corp., 323 F. Supp. 358 at 361 (S.D.N.Y. 1971). There, the District Court held that, under New York law, the court "retains the authority to substitute itself for the appraisers" and to overturn an appraisal that it finds rested on mistaken factual or legal grounds. That standard is completely inconsistent with the standard that the New York Court of Appeals applied in Penn

Central and that, as I said, the great bulk of the New York courts have applied ever since. And Clark was decided in 1971, a decade before Penn Central, so of course it's no basis for me to not follow Penn Central.

The Boards also rely on a more recent federal District Court case, Sauer v. Xerox Corp., 17 F. Supp. 2d 193 (W.D.N.Y. 1998). That case did postdate Penn Central, but I find it's entitled to no weight in deciding this issue of New York law. Its discussion of this issue consists of nothing other than a citation to Clark and a short quotation from Clark. It contains no discussion of any New York State cases, and it completely disregards the fact that any validity Clark might once have had was repudiated by the Court of Appeals in Penn Central.

One other case relied on by the Boards deserves mention — namely, the New York Court of Appeals' decision in 936 Second Avenue L.P. v. Second Corp. Development Co., 10 N.Y.3d 628 (2008). That was a case in which two parties had each hired their own appraiser. These two appraisers had reached different value conclusions based on using different assumptions about how to value the land. After the two party appraisers finished their appraisals, the two parties then asked the courts to determine the assumptions that a neutral appraiser should use to value the property.

In other words, this was not a case where a

neutral appraiser issued its report and the court overturned the appraisal on the ground that it had used the wrong assumptions. Instead, this was a case where the parties went to court before the neutral appraiser did his work, and asked the court to determine the standards the neutral should apply. Thus, this case, 936 Second Avenue, is not in any way inconsistent with the New York case law I've described, which addresses judicial review of appraisals after they have been completed.

Another argument advanced by the Boards is that the issues addressed and the materials considered by the neutral appraiser exceeded the permissible scope — specifically, that it was improper for the neutral to decide what assumptions to apply, and also improper for BPCA to send the neutral a letter brief advocating its view on that issue. I don't agree with this contention. I think it’s defeated by the undisputed facts that were presented to me.

Most important, the Boards willingly participated in the very process to which they now object. At the outset, the Boards instructed their own appraiser to use the standard they liked — that is, to value the property as subject to the mixed-use development requirement. They took that issue out of his hands. This is apparent from the appraisal that that the Boards' appraiser went on to issue, which is annexed to the Boards' motion as Exhibit H. At Page

8 of that appraisal, the appraiser states that he's been instructed to apply the standard that the Boards are advocating.

Throughout the process, the Boards have been represented by a highly capable and very experienced real estate litigator, Mr. Hiller. They undoubtedly knew all along that the issue of what standard to apply was a critical gating issue on which any appraisal would depend — that is, that it's not possible to do an appraisal of the land here without first deciding whether you're valuing the land as subject to encumbrances or not.

If the Boards believe it's not proper for an appraiser to decide this issue, they should have brought that issue to the Court for resolution before the neutral issued its appraisal, as the parties did in the Second Avenue case. The Boards should have asked the Court to determine what standard the appraiser should apply, and asked the appraiser to defer its work until the Court had made that determination. At a minimum, the Boards should have done this when they received the appraisal prepared by BPCA's appraiser, which applied a standard opposite to the one the Boards had directed their appraiser to apply.

I realize there was a tight schedule in place at that time. The stipulated scheduling order I had entered required the appraisal process to proceed quickly. So I

appreciate that at the time the Boards got the BPCA appraiser's appraisal, they would have had to act very quickly, and to ask me to act very quickly, if they had followed this approach.

However, the Boards are represented by sophisticated bankruptcy counsel as well as sophisticated real estate counsel, and it's well known that bankruptcy courts are capable of acting very quickly when it's necessary to do so. I've made clear to the parties on more than one occasion in this case, including prior to the time we're talking about, that I'm prepared to act very quickly whenever that is needed.

Most important, as I mentioned a moment ago, the Boards could have acted long before that time, since they must have known all along that this issue would be critical to any appraisal. So it's hard to avoid the conclusion that, if they believed it was not proper for the appraiser to decide this issue — that a court instead of an appraiser needed to decide it — they should have brought that issue to me before then, when there would have been plenty of time for me to address the issue.

Finally, I'm not persuaded that the issue of what encumbrance assumptions to apply was an issue that appraisers are not themselves qualified to decide. My understanding is that appraisers decide similar issues on a

somewhat regular basis. When a ground rent reset dispute arises and appraisers are brought in to value the land for that purpose, it's not uncommon that the landlord and the tenant may have different views on how the land should be valued — for example, whether or not the land should be valued as encumbered. And my understanding is it's not uncommon for the appraiser to make that decision. In any event, I don't have a record on whether that's common or not. What I can say is the Board has made no showing that it's uncommon, let alone unlawful or viewed as improper within the appraisal community. No showing of anything of that sort.

For all of these reasons, I find that it was not improper — and certainly not grounds to overturn the appraisal — for the neutral appraiser to consider the issue of what encumbrance assumptions to apply, or for BPCA to submit a letter brief to the neutral appraiser advocating its position on that issue.

The Boards argue, next, that I should overturn the appraisal on the ground that it was wholly irrational for the appraiser to value the property as if it were unencumbered. And they've cited at least one case for the proposition that a court can overturn an appraisal that it finds to be wholly irrational.

This argument fails for two reasons. First, it is

contrary to the standard of review adopted by the New York Court of Appeals in Penn Central and by the various Appellate Division cases that have followed Penn Central. "Wholly irrational" is not the same as fraud, bias, or bad faith. It's an expansion upon that standard. Thus, even if one or two lower courts may have reviewed appraisals using a "wholly irrational" standard, this is contrary to controlling New York law.

Second, the appraisal here is anything but wholly irrational. I'm not delivering a comprehensive ruling on the merits, because I've concluded that's outside the scope of proper judicial review in this case. But I have carefully reviewed the record. I have carefully considered the arguments of the parties on the merits as well as on the process issues, and I have read the case law carefully. The governing documents and the case law provide no support for the conclusion that the appraisal is wholly irrational.

As discussed earlier, the Boards acknowledge that it was proper for the appraiser not to consider the encumbrances contained in the ground lease or the master lease. Their contention is that the appraiser should have considered the encumbrances contained in the design guidelines, the condo declaration and bylaws, and the various condo deeds, all of which require the building to be developed as a mixed-use property, that is, to include a

hotel as well as residential units. However, the governing documents do not support this contention.

First, the design guidelines: No showing has been made that the design guidelines had any binding effect on the parties other than through the incorporation of those guidelines into the ground lease and/or the master lease. But for those leases, the parties would not have been bound to the design guidelines. Thus, a valuation of the land "as unencumbered by [the ground] lease and the master lease" means a valuation of the land as unencumbered by the design guidelines.

Second, the condo declaration and bylaws: I'm satisfied that, by their terms, those documents do not purport to encumber the land underlying the building. Rather, all they purport to encumber are the leasehold rights held by the various parties other than BPCA under the ground lease.

The Boards have argued that the declaration and bylaws are not clear in this regard, and I recognize there may be some ambiguity in the condo declaration and bylaws on this point. But any ambiguity of that sort would not matter, because the condo declaration and bylaws could not encumber the land even if they purported to. Other than BPCA, the parties had no rights to the land except the rights they had under the ground lease. These parties are free to carve up

their tenancy rights under the ground lease among themselves through the condo documents. But by contracting among themselves, they can't expand their rights vis-à-vis BPCA or vis-à-vis the land.

The same is true of the deeds — the hotel unit deed and the commercial unit deed, for example. These are merely deeds to condo units. They're not deeds to the land.

For these reasons, it's clear that the decision of the arbitrator is anything but wholly irrational. In fact, based on my review of the documents and the law, the neutral arbitrator appears to have been correct in his conclusions.

Let me address, finally, the Boards' argument that the outcome that I'm approving is unfair. I am sympathetic to the predicament my ruling poses for residential unit owners. My understanding is that the valuation the appraiser has blessed and I have now declined to overturn could result in an enormous increase in the ground rent paid by the building, which could translate into a large increase in the maintenance payments paid by residential unit owners.

BPCA has said that it is committed to not enforcing an outcome that will result in residents being unable to afford their apartments, and I'm aware that for a number of other buildings in Battery Park City, BPCA has had negotiations with the buildings and has wound up reducing the rent increases produced by the resetting of the ground

rent. I am hopeful that BPCA will enter into very serious negotiations with the residents of this building, as it has promised to do.

I understand there may be reasons why BPCA has not yet had extensive negotiations with this building, one of which is that this building has been engaged in pretty heated litigation with BPCA for a number of years now. It's understandable that a party that's being sued may be reluctant to make concessions that don't result in a settlement of the claims against it. That said, if BPCA has not already commenced serious negotiations with the Residential Board to try to solve this pressing problem, it is high time for those negotiations to begin.

However, these equitable considerations are not a basis to overturn the appraisal. New York law simply doesn't give a judge the ability to overturn an appraisal on the ground that it would lead to results that are unfair or that would cause grief for the losing party. Moreover, the equities here are tempered by that fact that, at bottom, this is a dispute over relatively high-end real estate, with all the risks such investments entail.

I'm aware my decision does not address every single argument that the Boards have made in their papers. The papers were lengthy and made a lot of arguments. I've addressed the arguments I consider the most serious. I want

to make clear, though, that I have considered and rejected all of the Boards' arguments, including those that my decision does not specifically mention.

This completes my ruling.