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07-Aug- **Alien vs. Predator: CMBS and CDO in court fight over rights to defaulted loans**

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Story A collateralized debt obligation and a commercial mortgage backed security are battling to collect on separate defaulted loans for the same hotel.

Highland Park CDO I, a USD 619.5m CDO, and Wells Fargo as trustee for Morgan Stanley Capital's USD 1.55bn Commercial Mortgage Pass-Through Certificates Series 2006-XLF, are both lenders on defaulted real estate loans apparently connected to the same Holiday Inn in Ohio. According to Wells Fargo, the hotel has 338 rooms and an indoor water park. Highland Park stated in court papers it is trying to collect on a mezzanine loan with an original principal balance of USD 10.5m, and the Morgan Stanley CMBS has said it has a senior loan with an original principal balance of USD 28.5m.

With commercial loan defaults on the rise, it's almost inevitable that similar conflicts will emerge in the near term, said one Wall Street research analyst. "You're going to see a lot more of that going forward," the analyst said. Because of the way recent commercial loans were cut up into different pieces and securitized, there are now "many more parties, each with different interests and objectives and that can just make the workout process more convoluted," the analyst said.

Wells Fargo, as trustee for the Morgan Stanley CMBS, filed suit in Ohio State Court, after a group of four individuals defaulted on the loan in February. However, Highland Park CDO filed suit 20 February in Federal Court in New York's southern district in an effort to collect on its USD 10.5m mezzanine loan made to the same set of borrowers. On 10 June, CMBS trustee Wells Fargo filed a motion in Highland's Park case to intervene and get Highland's case dismissed. For one thing, Wells Fargo said, Highland Park held a subordinate interest in the loan, and according to an intercreditor agreement, the CDO did not have a right to bring the court action. Also, Wells Fargo said, if the Federal Court case is allowed to proceed, its interest in the senior loan could be in jeopardy should the Ohio and Federal courts hand down conflicting judgments.

Meanwhile, the defendants in the case have argued that Highland's case should be dismissed. Their reasoning is that it is not clear that Highland has standing to bring the lawsuit. In a 7 August filing, defendants' attorney Daniel Katz of Bauman Katz & Gill asserted that "a review of the Mezzanine Loan Sale and Participation Agreement...reveals that it is not entirely clear that Plaintiff has the right to bring or settle this lawsuit without the prior written approval of Morgan Stanley."

Katz did not return a call seeking comment, and attorneys for Wells Fargo and for Highland Park also had not returned calls by press time.

"Intercreditor Agreements in the loan context are typically very clear as to the rights of the senior and subordinated lenders since the entire document is dedicated to spelling out those rights," said Greg Cioffi, a partner and Seward & Kissel's Securitization and Restructuring Group who is not involved in the cases. "They go into painstaking detail as to who gets paid first and who can enforce the rights and remedies against the borrowers or guarantors. Intercreditor Agreements also typically prohibit the junior creditors from even bringing actions until the senior creditors have been paid off or have exhausted their remedies."

The respective loan amounts in question may perhaps have a somewhat greater potential impact for the CDO, with an original 619.5m total asset value (according to a recent Wachovia report) than for the 1.55bn CMBS transaction. In either case, even a total loss would not be enough by itself to significantly harm either deal. Highland Park did, however, have six classes of notes placed on watch negative by Standard and Poor's on 29 May. So far the Morgan Stanley CMBS has not had any negative rating actions from either S&P or Moody's.

By Danielle Reed, New York