

NOT TO BE PUBLISHED WITHOUT THE APPROVAL  
OF THE COMMITTEE ON OPINIONS

STONEWALL OF SADDLE RIVER,  
L.P., a New Jersey Limited Partnership,

Plaintiff,

vs.

NORTHEAST LINEN SUPPLY CORP.,  
INC., a Delaware Corporation,

Defendant/Third Party Plaintiff,

vs.

NORTH AMERICAN LINEN, LLC,  
Formerly a New Jersey Limited Liability  
Company,

Third Party Defendant.

SUPERIOR COURT OF NEW JERSEY

LAW DIVISION

BERGEN COUNTY

DOCKET NO. BER-L-2387-15

CIVIL ACTION

OPINION

**Argued: December 4, 2015**

**Decided: February 3, 2016**

**Honorable Robert C. Wilson, J.S.C.**

Ronald L. Davison, Esq., appearing for the Plaintiff, Stonewall of Saddle River, L.P., (from the law offices of Starr, Gern, Davison & Rubin P.C.).

Richard J. Allen, Jr., appearing for the Defendant, North East Linen Supply Co., Inc., (from the law offices of Kipp & Allen, L.L.P.).

**FACTUAL BACKGROUND**

**THIS MATTER** arises out of a contractual dispute between Stonewall of Saddle River, L.P. (hereinafter “Plaintiff” or “Stonewall”) and North East Linen Supply Co., Inc. (hereinafter “Defendant” or “NELS”) regarding the validity and purported violation of the Note and Warrant

Purchase Agreement, which has since been amended after its execution in April 2008. The factual background that precipitated this litigation is not in great dispute.

A. Structure and Status of Parties Pursuant to Loan Agreements.

Prior to April of 2008, North American Linen, LLC (“NA Linen”) operated a commercial laundry on leased premises in Long Branch, New Jersey. On April 17, 2008, NA Linen sold the assets of its commercial laundry business to Defendant NELS for a purchase price of \$3,382,686. Of the total purchase price, NA Linen and NELS agreed that NELS would make and deliver to NA Linen a promissory note in the amount of \$1,047,565 (hereinafter the “Promissory Note”). On April 17, 2008, in conjunction with the sale, the parties executed and delivered the Promissory Note. The validity of the promissory note is not at issue in this litigation. Additionally, a portion of the consideration for the purchase of assets by NELS from NA Linen was funded through loans from TD Banknorth, N.A. (hereinafter “TD Bank”), Ironwood Mezzaine Fund, L.P. (hereinafter “Ironwood”), Kevin M. McCafferty (hereinafter “McCafferty”) and Donero Investment Company, LLC (hereinafter “Donero”).

The senior status of Ironwood, McCafferty, and Donero came to fruition as follows. On April 17, 2008, NA Linen assigned the Promissory Note to Stonewall in consideration of Stonewall cancelling and discharging liens it held on NA Linen’s assets in order to secure repayment of loans that Stonewall made to NA Linen in excess of \$3,000,000. NELS financed a portion of the purchase price of its acquisition of NA Linen’s assets by obtaining loans from Ironwood Mezzaine Fund, L.P., Kevin M. McCafferty, and Donero Investment Company, LLC (hereinafter the “Ironwood Lenders”). The obligation of NELS to repay the Ironwood Lenders and the terms and conditions of the loan were memorialized in an Amended and Restated Note and Warrant Purchase Agreement, dated April 18, 2008. The April 18, 2008 Amended and Restated Note and Warrant Purchase Agreement amended and/or modified the Note and Warrant Purchase Agreement,

executed September 28, 2004, executed by NELS and Ironwood Mezzaine Fund, L.P., formerly known as Ironbridge Mezzaine Fund, L.P.

As a condition of the Ironwood Lenders' loan to NELS, the obligations of NELS to NA Linen under the Promissory Note was subordinated to the obligations of NELS to Ironwood Lenders. The obligations of NELS to NA Linen under the Promissory Note were denominated as a "Subordinated Indebtedness" and the Ironwood Lenders were considered the "Senior Lenders". This agreement to subordinate the debt of NELS to NA Linen was memorialized in the Subordination and Intercreditor Agreement, dated April 18, 2008, among the Ironwood Lenders, NA Linen, and NELS (hereinafter "the Subordination Agreement").

The debt owed to TD Bank North, N.A. was refinanced and discharged. To effectuate the TD Banknorth refinance, the Senior Lenders agreed to subordinate their rights in the Senior Indebtedness to the debt of Rockland Bank and Advantage Capital by virtue of loan agreements among the Senior Lenders, Rockland Bank, and Advantage Capital. The loan agreements also contained financial covenants to be met by NELS.

Stonewall and NELS were represented by legal counsel when they knowingly and voluntarily executed the loan agreements, including the Promissory Note, Subordination Agreement, the Note and Warrant Purchase Agreement, and the Amended Note and Warrant Purchase Agreement (hereinafter the "loan agreements"). Neither Stonewall nor NELS asserts that either party entered into these agreements under duress, fraud, or mistake.

a. Contractual Provisions Governing Payment of Principal and Interest.

The crux of Stonewall's summary judgment motion is predicated on the parties' understanding with respect to the provisions governing the terms of "principal amount" and "interest". Stonewall contends that NELS increased the original principal amount of \$4,500,000 more than \$1,000,000 in contravention of the loan agreements. Stonewall argues that this

purported contractual violation constitutes a material breach of the contract, which excuses Stonewall of any future performance of its contractual obligations and renders the loan agreements null and void.

Stonewall expressly holds a subordinated interest to that the Senior Lenders. The Promissory Note memorializes Stonewall's subordinated status and clearly states in bold capital letters that:

**THIS NOTE AND THE INDEBTEDNESS EVIDENCED HEREBY IS SUBORDINATED TO BOTH (A) INDEBTEDNESS OF BORROWER TO TD BANK NORTH, N.A., UNDER THE TERMS OF A SUBORDINATION AND INTERCREDITOR AGREEMENT DATED AS OF APRIL 17, 2008, AND (B) INDEBTEDNESS OF BORROWER TO IRONWOOD MEZZAINE FUND, LP, KEVIN M. McCAFFERTY AND DONERO INVESTMENT COMPANY, LLC UNDER THE TERMS OF A SUBORDINATION AND INTERCREDITOR AGREEMENT DATES AS OF APRIL 17, 2008.**

(See Def.'s Statement of Material Facts In Supp. Of Def.'s Mot. For Summ. J. And In Opp. To Pl.'s Mot. For Partial Summ. J., at 3). The Subordination Agreement defines "Subordinated Indebtedness" as "all principal (whether scheduled or due pursuant to mandatory or optional prepayment obligations), interest, payments, or other distributions (in cash or in equity interests) in respect of amounts payable or chargeable in connection with any indebtedness now or hereafter owing to any Subordinated Lender, including without limitation the Subordinated Note and any other sums owing to any Subordinated Lender under that certain Asset Purchase Agreement dated as of March 31, 2008 among other payments in respect of the Subordinated Indebtedness under any confirmed plan of reorganization or other plan of distribution, or otherwise provided in connection with an Event". (See McCafferty Cert. in Opp. To Pl.'s Mot. For Summ. J., Ex. B, at 3). In addition, the Subordination Agreement defines the "Subordinated Note" as "that certain promissory note issued by the Borrower to Subordinated Lender in the original principal amount

of \$1,047,565.00 dated April 15, 2008, together with any extensions thereof, securities issued in exchange therefore or modification or amendments thereto or replacements and substitutions thereof.” (See McCafferty Cert., Ex. B, at 4).

Furthermore, the Promissory Note advised that it was subject to the Subordination and Intercreditor Agreement, dated April 17, 2008, among the Borrower, the Lender, and TD Banknorth, N.A., as well as the Subordination Intercreditor Agreement, dated April 17, 2008, among the Borrower, the lender, and Ironwood Mezzaine Fund LP, Kevin M. McCafferty, and Donero Investment Company, LLC. Section 2.2 of the Subordination Agreement specifically provides that:

Subordination Provisions. Notwithstanding any other provision of the Subordinated Indebtedness to the contrary, any Distribution with respect to the Subordinated Indebtedness is and shall be expressly junior and subordinated in right of payment to all amounts due and owing upon all Senior Indebtedness outstanding from time to time as follows:

- (a) Payments. The Borrower shall not make any Distribution on the Subordinated Indebtedness until such time as the Senior Indebtedness shall have been paid in full in cash and the Note and Warrant Purchase Agreement shall have been terminated; provided, however, the Borrower may pay, and the Holders of Subordinated Indebtedness may receive, (i) regularly scheduled cash payments of principal and interest on the Subordinated Indebtedness as set forth on the date hereof in the Subordinating Lending Agreements but in no event earlier than 30 days prior to the last date such scheduled payments can be made and (ii) costs and expenses to be reimbursed to Subordinated Lender from time to time as set forth on the date hereof in the Subordinated Lending Agreements and as permitted in writing by the Senior Lenders (“Permitted Expenses”, together with item (i) above being collectively referred to as “Permitted Payments”).

(See McCafferty Cert. in Opp. To Pl.’s Mot. For Summ. J., Ex. B, at 4).

Moreover, Pursuant to Section 4.8 of the Subordination Agreement, the Senior Lenders (*i.e.*, the Ironwood Lenders) retained the right to alter or amend the terms of the Senior Indebtedness without impairing the Senior Lenders’ priority rights as the Senior Lenders vis-à-vis

NA Linen and the Subordinated Indebtedness so long as the principal amount of the Senior Indebtedness of April 18, 2008 was not increased by more than \$1,000,000 without prior written consent of the Subordinated Lender. The Plaintiff submits that NA Linen negotiated for a cap of \$1,000,000 on the Senior Indebtedness to ensure that if NELS were to default, the \$1,000,000 would wholly prevent or partially mitigate a total lack or insufficiency of funds remaining after payment of the Senior Indebtedness to pay off the debt to Stonewall. As of April 18, 2008, the principal amount of the Senior Indebtedness was \$4,500,000.

After April 2008 the outstanding Senior Indebtedness was increased from \$4,500,000 to \$9,397,582, comprised of the original principal and accrued interest. Both parties acknowledge that the increase in the principal amount of the Senior Indebtedness was attributed to the accrual of unpaid interest only on the Senior Indebtedness. However, the parties disagree as to whether “principal amount” included accrued interest. The Plaintiff argues that if the “principal amount” included accrued interest, then the Defendant materially breached the terms of the Subordination Agreement by increasing the principal amount from \$4,500,000 to \$9,397,582. The Plaintiff quotes several provisions set forth in the Amended and Restated Note and Warrant Purchase Agreement relating to interest, which supposedly prove that the parties agreed to treat accrued and unpaid interest as additions to or part of the principal amount. These provisions are as follows:

2.4 Interest. The Borrower shall pay interest (“Interest”) on the unpaid principal amount of the Notes at a rate of FOURTEEN PERCENT (14%) per annum (the “Interest Rate”). Interest on the Notes shall accrue from and including the date of issuance through and until repayment of the principal amount of the Notes, and payment of all Interest on full, and shall be computed on the basis of a 360-day year comprised of twelve 30-day months. Except as prohibited by the Senior Loan Subordination Agreement, Interest shall be paid as follows:

- (a) Basic Interest. The Borrower shall pay Interest (the “Basic Interest”) on the unpaid principal amount of the Notes at the rate of TWELVE PERCENT (12%) per annum (the “Basic Interest Rate”) in arrears...[.]

(b) Deferred Interest. Notwithstanding Section (a) above, Borrower shall have the right to pay Basic Interest at the rate of 6% per annum and defer the payment of Interest at the rate of 6% per annum, compounded monthly (the “Deferred Interest”) at any time through March 31, 2009 in order to comply with the financial covenants required by the Senior Loan Documents. On March 31, 2009, and earlier on any Interest Payment Date if requested by the Investors, Borrower shall pay the aggregate amount of accrued and unpaid Deferred Interest by delivering to each Investor an additional promissory note...having an aggregate principal amount equal to the accrued but unpaid Deferred Interest on the respective Note held by such Investor (and the amount of accrued but unpaid Deferred Interest on any previously delivered Deferred Interest Notes but without duplication) and otherwise having substantially identical terms to such Note (including, with respect to the Interest Rate)...If for any reason a Deferred Interest Note is not delivered in accordance herewith, Interest shall accrue on each Note such that the aggregate Interest due and payable on the Maturity Date and on each anniversary date or Interest Payment Date, as applicable, would be the same as if all Deferred Interest Notes not issued had been issued and bore interest at the Interest Rate, and the principal payable on the Maturity Date with respect to each Note shall be an amount equal to the sum of the principal outstanding hereunder and the aggregate principal which would be outstanding if the Deferred Interest Notes not issued had been issued. Notwithstanding the foregoing, at the option of the Borrower, Deferred Interest may be paid in cash on any one or more Interest Payment Dates without penalty.

(c) PIK Interest. The Borrower shall pay Interest (“PIK Interest”) on the unpaid principal amount of each Note, compounded monthly, at a rate of TWO PERCENT (2%) per annum (the “PIK Interest Rate”) in arrears by delivery to each Investor, by a date no later than each December 31 (or, following the occurrence of an Event of Default, each March 31, June 30, September 30, and December 31) in each calendar year (each such date, a “PIK Interest Payment Date”), of an additional promissory note...having an aggregate principal amount equal to the accrued by unpaid PIK Interest on the respective Note held by such Investor (and the amount of accrued but unpaid PIK Interest on any previously delivered PIK Note) and otherwise having substantially identical terms to such Note including with respect to the Interest Rate. Interest on the principal amount of each PIK Note (which shall include previously accrued compounded interest in respect thereof) shall accrue at the Interest Rate from the PIK Interest Payment Date in respect of which such additional PIK Note was issued until repayment of the principal thereof and payment of all accrued interest in full. If for any reason one or more PIK Notes shall not be delivered in accordance herewith, Interest shall accrue on each Note such that the aggregate Interest due and payable on the Maturity Date and on each Interest

Payment Date would be the same as if all PIK Notes not issued had been issued, and the principal payable on the Maturity Date with respect to each Note shall be an amount equal to the sum of the principal outstanding thereunder and the aggregate principal which would be outstanding if the PIK Notes not issued had been issued...[.]

(See Harvey R. Poe, Esq. Cert. In Supp. Of Pl.'s Mot. For Summ. J., Ex. F, Section 2.4, at 16-17).

The terms governing "Basic Interest" are self-explanatory; the Borrower, NELS, was obligated to pay 12% monthly interest on the unpaid principal. The terms governing "Deferred Interest" and "PIK Interest" are more convoluted. The Plaintiff interprets the terms governing "Deferred Interest" to provide that the Borrower has the right to elect to pay the Basic Interest at 6% and defer payment of interest at 6% through March 31, 2009. If the Borrower elects to defer interest, it must provide a Deferred Interest Note equal to the amount of the deferred accrued interest that carries an interest rate of 14%. The Plaintiff asserts that the parties defined "principal" as principal and interest, as the terms of Deferred Interest provide that "[i]f a Deferred Interest Note is not issued, then Interest will accrue as if all Deferred Interest Notes had been issued and 'the principal payable on the Maturity Date with respect to each Note shall be an amount equal to the sum of the principal outstanding hereunder and the aggregate principal which would be outstanding if the Deferred Interest Notes not issued had been issued.'" (See Pl.'s Statement of Material Facts in Supp. Of Pl.'s Mot. For Summ. J., at 6-7). The Plaintiff does not clearly articulate how this language supports its legal argument, however, the Court presumes that the Plaintiff interprets this language to mean that the Deferred Interest is effectively converted to new, additional principal characterized as the Deferred Interest Note, or an accumulation of all sums outstanding including the initial principal sum plus outstanding deferred interest amounts.

Similarly, the Plaintiff interprets the terms governing "PIK Interest" to provide that the Borrower must pay PIK Interest on the unpaid principal amount of each Note, compounded monthly, at the rate of 2% by delivering to Ironwood Lenders on by December 31<sup>st</sup> an additional



promissory note having an aggregate principal amount equal to that accrued but unpaid PIK Interest on the respective Note held by such investor. Interest on the principal amount of each PIK Note (including previously compounded interest in respect thereof) shall accrue at the 14% interest rate. If an Interest Note is not issued, then Interest will accrue as if all PIK Notes had been issued and the principal payable on the Maturity Date with respect to each PIK Note shall be an amount equal to the sum of the principal outstanding thereunder and the aggregate principal which would be outstanding if the PIK notes issued had been issued. The Plaintiff interprets this language to mean that the PIK Interest is effectively converted to new, additional principal characterized as the PIK Interest Note, or that the principal is an accumulation of all sums outstanding including the initial principal sum plus outstanding PIK Interest amounts.

The Plaintiff reads the above-enumerated Interest terms in conjunction with Section 4.8 of the Subordination Agreement, which prohibits the Senior Lenders from increasing the principal amount of the aggregate facilities, as set forth in the Senior Lending Agreements on April 18, 2008, by more than \$1,000,000 without the prior written consent of Subordinated Lender, which consent will not be unreasonably withheld, conditioned or delayed. Accordingly, these provisions, read conjunctively, supposedly prove that the Plaintiff and Defendant envisioned that the principal amount was inclusive of the original principal sum and accrued interest, which was to be capped at \$1,000,000 unless prior consent of Stonewall was obtained.

Stonewall contends that NELS did not seek or obtain its consent prior to purportedly increasing the principal amount of the Senior Indebtedness from \$4,500,000 to a total amount of \$9,397,582. Stonewall argues that NELS materially breached the Subordination Agreement and related loan agreements when it increased the principal amount as such. In addition, the Maturity Date of the obligation under the Amended and Restated Note and Warrant Purchase Agreement was extended several times, most recently to September 15, 2015, by agreement between the

Ironwood Investors and NELS. Stonewall contends that NELS did not seek or obtain its consent to extend the Maturity Date and therefore, NELS breached its contractual covenants set forth in the loan agreements.

NELS articulates a different interpretation of the loan agreements between the parties, and asserts three justifications for denying Stonewall's summary judgment motion. Specifically, that NELS has not materially breached the Subordination Agreement and that the Subordination Agreement remains in full force and effect and as such, Stonewall lacked the basis to initiate this lawsuit and seek recompense of attorney's fees. Secondly, that even if, *arguendo*, NELS breached the Subordination Agreement, Stonewall's proposed remedy, to nullify the agreement is not legally or contractually cognizable. Thirdly, summary judgment should be not granted here because doing so would prejudice the rights of third parties, namely the Senior Lenders who are indispensable parties, but have not been joined in this lawsuit. Lastly, NELS moves for summary judgment on several of Stonewall's claims analyzed below.

In support of its motion, NELS enumerates definitions of "Subordinated Indebtedness" and "Subordinated Note" that govern the agreement between the parties. Pursuant to the Subordination and Intercreditor Agreement, "Subordinated Indebtedness" is defined as:

All principal (whether scheduled or due pursuant to mandatory or principal prepayment obligations), interest, payments, or other distributions (in cash or equity interests) in respect of amounts payable or chargeable in connection with any indebtedness now or hereafter owing to any Subordinated Lender, including without limitation that Subordinated Note and any other sums owing to any Subordinated Lender under certain Asset Purchase Agreement dated as of March 31, 2008 among Subordinating Lenders and North East, and shall include any distributions of assets or other payments in respect of the Subordinated Indebtedness under any confirmed plan of reorganization or other plan of distribution, or otherwise provided in connection with an Event.

(See Poe Cert., Ex. G, at 3). NELS interprets this definition as setting apart the "principal" and "interest" portions of the Senior Indebtedness. Additionally, the "Subordinated Note" is defined

as “that certain promissory note issued by the Borrower to Subordinated Lender in the original principal amount of \$1,047,565.00 dated April 15, 2008, together with any extensions thereof, securities issued in exchange therefore or modification or amendments thereto or replacements and substitutions therefore.” (See Poe Cert., Ex. G, at 3). NELS argues that the original principal amount remains separate and distinct from any subsequent accrued interest, even though the ultimate outstanding balance due includes the original principal amount and accrued interest, which would have been contemplated as occurring when the agreement was consummated.

b. Rights of Stonewall to Receive Payment in the Event of Default.

NELS emphasizes that that on April 17, 2008, North American assigned the Promissory Note to Stonewall. As the successor and assign of North American, Stonewall is bound to the terms of the Subordination Agreement. Section 2.2 of the Subordination Agreement specifically provides that:

Notwithstanding any other provision of the Subordinated Indebtedness to the contrary, any Distribution with respect to the Subordinated Indebtedness is and shall be expressly junior and subordinated in right of payment to all amounts due and owing upon all Senior Indebtedness outstanding from time to time as follows:

(a) Payments. The Borrower shall not make any Distribution on the Subordinated Indebtedness until such time as the Senior Indebtedness shall have been paid in full in cash and the Note and Warrant Purchase Agreement shall have been terminated; provided, however, that subject to Sections 2.2(b), (c), (d), and (e) below, the Borrower may pay, and the Holders of Subordinated Indebtedness may receive, (i) regularly scheduled cash payments of principal and interest on the Subordinated Indebtedness as set forth on the date hereof in the Subordinating Lending Agreements but in no event earlier than 30 days prior to the last date such scheduled payments can be made and (ii) costs and expenses to be reimbursed to Subordinated Lender from time to time as set forth on the date hereof in the Subordinated Lending Agreements and as permitted in writing by the Senior Lenders (“Permitted Expenses”, together with item (i) above being collectively referred to as “Permitted Payments”).

(See McCafferty Cert. in Opp. To Pl.'s Mot. For Summ. J., Ex. B, Section 2.2(a), at 4). Additionally, Section 4.3 of the Subordination Agreement defined the Senior Lenders' right to enforce the provisions of the Subordination Agreement as follows:

The right of Senior Lenders to enforce the provision of this Agreement shall not be prejudiced or impaired by any act or omitted act of the Borrower or Senior Lenders including forbearance, waiver, consent, compromise, amendment, extension, renewal, or taking or release of security in respect of any Senior Indebtedness or noncompliance by the Borrower with such provisions, regardless of the actual or imputed knowledge of Senior Lenders.

(See McCafferty Cert., Ex. B, Section 4.3, at 8). NELS asserts that the above-enumerated provisions permitted payments to be made to Stonewall under certain circumstances.

However, NELS was prohibited from making payments to Stonewall upon NELS' default of its financial covenants, as set forth in Section 2.2(g) of the Subordination Agreement. Section 2.2(g) defines "event of default" under the Subordinated Note and/or Subordinated Lending Agreements as "any failure to make a payment under the Subordinated Note and/or Subordinated Lending Agreements so that payments received by any Holder of Subordinated Indebtedness following any such occurrence shall not be retained." (See McCafferty Cert., Ex. B, at 6). Additionally, Section 2.2(i), which defines "Subrogation", provides that:

Subject to the prior payment in full in cash of the Senior Indebtedness and the irrevocable termination of the Note and Warrant Purchase Agreement, to the extent that Senior Lenders received any Distribution on the Senior Indebtedness, Subordinated Lender shall be subrogated to the then or thereafter rights of the Senior Lenders including, without limitation, the right to receive any Distribution made on the Senior Indebtedness until the principal of, interest on and other charges and amounts due under the Subordinated Indebtedness shall be paid in full.

(See McCafferty Cert., Ex. B, Section 2.2(i), at 6). In accordance with these provisions, Stonewall was permitted to receive payments until the rights of the Senior Lender were triggered upon default, at which time Stonewall could no longer receive such payments.

The Senior Lenders were aware that starting in 2008, NELS made payments to Stonewall on account of the Subordinated Note. In or around 2009 and 2010, NELS was negatively impacted by the recession and failed to meet its financial covenants memorialized in the loan agreements. NELS informed Stonewall that it could no longer make payments. However, NELS submits that it continued to make payments, with the permission of the Senior Lenders, as a “courtesy” to Stonewall. NELS denies that it made such payments in contravention of the loan agreements, or with the intent to waive and/or terminate such agreements. In April 2014, the Senior Lenders learned that NELS was non-compliant with the loan agreements made with Rockland Bank and Advantage Capital, entities superior to the “Senior Lenders”. In light of that, the Senior Lenders informed NELS that NELS must cease making any “courtesy” payments to Stonewall.

NELS contends that Stonewall knew or should have known that the Subordination Agreement prohibited NELS from continuing to make payments to Stonewall upon an event of default under the loan agreements. Specifically, Section 2.2(c) of the Subordination Agreement provides that “[n]o holder of Subordinated Indebtedness shall be entitled to accelerate the maturity of the Subordinated Indebtedness, exercise any remedies or commence any other action or proceeding to recover any amounts due or to become due with respect to Subordinated Indebtedness.” (See McCafferty Cert., Ex. B, Section 2.2(c), at 5). NELS argues that Stonewall’s attempt to collect on the Promissory Note in this litigation violates the Subordination Agreement and Promissory Note.

c. Provisions Governing Waiver and Amendments.

Stonewall contends that voluntary “courtesy” payments by NELS to Stonewall constituted an effective waiver of the loan agreements, specifically the Subordination Agreement and Promissory Note. In contrast, NELS asserts that it continued to make payments to Stonewall despite the event of default as a “courtesy” to Stonewall. The Subordination Agreement provides

that “[a]ny waiver or amendment must be evidenced by a signed writing of the party to be bound thereby, and shall only be effective in the specific instances.” (See McCafferty Cert., Ex. B, Subsection 4.12, at 12). Neither Defendant nor the Plaintiff submitted to the Court any agreement, either formal or informal, to waive and/or amend any of the provisions of the loan agreements.

### **PROCEDURAL HISTORY**

**THIS MATTER** was commenced on March 10, 2015 by way of the Plaintiffs’ Complaint. The Plaintiff filed an Amended Complaint shortly thereafter. On May 11, 2015, the Defendant filed its Answer to the First Amended Complaint, Counterclaim, and Third Party Complaint. In its counterclaim, NELS asserted that it is entitled to a declaratory judgment adjudging that: it was not obligated to remit payments to Stonewall pursuant to the Promissory Note unless sanctioned under the Subordination Agreement; it is entitled to set-off from any balance due to Stonewall on the Promissory Note any amount owed to NELS by NA Linen as a result of NA Linen’s obligation to indemnify NELS; it is entitled to set-off from the balance due to NA Linen or its assignee on the Promissory Note all of its expenses, including reasonable attorney’s fees, incurred in the defense of this action; and, a constructive trust must be imposed on all monies paid by Defendant NELS to Stonewall for the benefit of the Senior Lenders.

While discovery was scheduled only to end on August 3, 2016, both the Plaintiff and Defendant moved for summary judgment. At oral argument, held December 4, 2015, the parties agreed that the Court should decide the pending motions for summary judgment and further discovery was not needed. The parties stipulated that the Court should now dispose of the case, as the only issues that existed were issues of law.

### **SUMMARY JUDGMENT STANDARD**

The New Jersey procedural rules state that a court shall grant summary judgment “if the pleadings, depositions, answers to interrogatories and admissions on file, together with the affidavits, if any, show that there is no genuine issue as to any material fact challenged and that the moving party is entitled to a judgment or order as a matter of law.” N.J.S.A. § 4:46-2(c). In Brill v. Guardian Life Insurance Co., 142 N.J. 520 (1995), the Supreme Court set forth a standard for courts to apply when determining whether a genuine issue of material fact exists that requires a case to proceed to trial. The New Jersey procedural rules state that a court shall grant summary judgment “if the pleadings, depositions, answers to interrogatories and admissions on file, together with the affidavits, if any, show that there is no genuine issue as to any material fact challenged and that the moving party is entitled to a judgment or order as a matter of law.” N.J.S.A. § 4:46-2(c). In Brill v. Guardian Life Insurance Co., 142 N.J. 520 (1995), the Supreme Court set forth a standard for courts to apply when determining whether a genuine issue of material fact exists that requires a case to proceed to trial. Justice Coleman, writing for the Court, explained that a motion for summary judgment under N.J.S.A. § 4:46-2 requires essentially the same analysis as in the case of a directed verdict based on N.J.S.A. § 4:37-2(b) or N.J.S.A. § 4:40-1, or a judgment notwithstanding the verdict under N.J.S.A. § 4:40-2. Id. at 535-536. If, after analyzing the evidence in the light most favorable to the non-moving party, the motion court determines that “there exists a single unavoidable resolution of the alleged dispute of fact, that issue should be considered insufficient to constitute a ‘genuine’ issue of material fact for purposes of N.J.S.A. § 4:46-2.” Id. at 540.

“The determination whether there exists a genuine issue with respect to a material fact challenged requires the motion Judge to consider whether the competent evidential materials presented, when viewed in the light most favorable to the non-moving party in consideration of the applicable evidentiary standard, are sufficient to permit a rational fact finder to resolve the alleged disputed issue in favor of the non-moving party.” Brill, supra at 523.

## **RULE OF LAW AND DECISION**

Under the prevailing law in New Jersey governing security interests, a perfected security interest has priority over a conflicting unperfected security interest in the same collateral. See N.J.S.A. § 12A:9-322(a)(2). Conflicting perfected security interests in the same collateral generally have priority according to the time of filing or the time of perfection. See N.J.S.A. § 12A:9-322(a)(1). “Collateral” is defined as “the property subject to a security interest or agricultural lien”, including “accounts, chattel paper, payment intangibles, and promissory notes that have been sold[.]” N.J.S.A. § 12A:9-102(a)(12)(B). Special rules, inapplicable here, govern priority in other arrangements, including deposit accounts, see N.J.S.A. § 12A:9-327; investment property, see N.J.S. § 12A:9-328; and, letter-of-credit rights, see N.J.S.A. § 12A:9-329. New Jersey law provides that a party with a security interest entitled to priority may, by agreement, subordinate the interest to another security interest. See N.J.S.A. § 12A:9-339.

A subordination agreement constitutes a contract. See N.J.S.A. § 12A:9-339. In interpreting a contract, a court generally turns first to a contract’s plain language. See Kieffer v. Best Buy, 205 N.J. 213, 223 (2011). A court’s task is not to rewrite a contract for the parties better than or different from the one they wrote for themselves. See Zacarias v. Allstate Ins. Co., 168 N.J. 590, 595, 775 A.2d 1262 (2001). Thus, a court should give contractual terms “their plain and ordinary meaning”, see M.J. Paquet, Inc. v. N.J. Dep’t of Transp., 171 N.J. 378, 396, 794 A.2d 141 (2002), unless the parties use specialized language peculiar to a particular trade, profession, or industry, see VRG Corp. v. GKN Realty Corp., 135 N.J. 539, 548, 641 A.2d 519 (1994); see also N.J.S.A. § 12A:1-205. Additionally, in interpreting a contract, a court must consider it as a whole, without isolating certain provisions from others that pertain to the same subject. See Newark Publishers Ass’n v. Newark Typographical Union, 22 N.J. 419, 425, 126 A.2d 348 (1956).



“The interpretation of a contract is a legal question for the court and may be decided on summary judgment unless there is uncertainty, ambiguity or the need for parol evidence in aid of interpretation” Celanese Ltd. v. Essex Cnty. Imp. Auth., 404 N.J. Super. 514, 528 (App. Div. 2009) (internal citations omitted). Therefore, interpretation of the terms of the loan agreements may be decided by the Court as a matter of law in the absence of any uncertainty or ambiguity dependent on testimony or other evidence. See id.

A. The term “Principal” as Defined in the Loan Agreements Does Not Include “Interest”.

The Court first disposes of Stonewall’s claim that principal includes interest and thereby, the purported increase in the original principal amount of \$4,500,000 to \$9,397,582 violated the Subordinated Agreement and related loan agreements. As explained in the factual background, Stonewall interprets the language contained in the provisions governing interest, including basic, deferred, and PIK interest, as supporting its contention that principal included principal and accrued interest. Stonewall relies on Section 4.8 of the Subordination Agreement in support of its allegation that NELS breached the Subordination Agreement by increasing the principal of the Senior Indebtedness by more than \$1,000,000 with its consent. Section 4.8 states in pertinent part:

Notwithstanding the foregoing, and so long as any Subordinated Indebtedness remains unpaid, the Senior Lenders agree that they will not increase the principal amount of the aggregate facilities, as set forth in the Senior Lending Agreements on the date hereof, by more than \$1,000,000 without the prior written consent of Subordinated Lender, which consent will not be unreasonably withheld, conditioned or delayed.

(See Poe Cert. in Supp. of Pl.’s Mot. For Summ. J., Ex. G, at 9). The Subordination Agreement defines the term “Senior Lending Agreements” to mean the Note and Warrant Purchase Agreement, executed September 28, 2004, the Notes and Note Documents, each as from time to time in effect or any documents that replace such documents connection with a refinancing of the

Senior Indebtedness. Here, the Amended and Restated Note and Warrant Purchase Agreement, executed April 18, 2008, replaced the September 28, 2004 Note and Warrant Purchase Agreement.

The Amended and Restated Note and Warrant Purchase Agreement was executed in conjunction with the Subordination and Intercreditor Agreement, dated as of April 18, 2008, which subordinates the Subordinated Indebtedness to the Senior Indebtedness. The Amended and Restated Note and Warrant Purchase Agreement memorialized the status or standing of the parties with respect to repayment and NELS's obligation to repay the Ironwood Lenders, the Senior Lenders. Collectively, these loan agreements provide a current list of definitions, including the definition of "Subordinated Indebtedness" and terms concerning interest.

The purpose of the Subordination Agreement is clear on its face. The Subordination Agreement explicitly states that at the request of the Ironwood Lenders, the Senior Lenders, to purchase certain Notes from NELS, the Borrower, NA Linen, the Subordinated Lender, agreed to enter into the Subordination Agreement to provide for the subordination of the Subordinated Indebtedness, held by NA Linen, to the Senior Indebtedness, held by the Ironwood Lenders. Pursuant to the Subordination Agreement, "Subordinated Indebtedness" is defined as:

All principal (whether scheduled or due pursuant to mandatory or principal prepayment obligations), interest, payments, or other distributions (in cash or equity interests) in respect of amounts payable or chargeable in connection with any indebtedness now or hereafter owing to any Subordinated Lender, including without limitation that Subordinated Note and any other sums owing to any Subordinated Lender under certain Asset Purchase Agreement dated as of March 31, 2008 among Subordinating Lenders and North East, and shall include any distributions of assets or other payments in respect of the Subordinated Indebtedness under any confirmed plan of reorganization or other plan of distribution, or otherwise provided in connection with an Event.

(See McCafferty Cert. in Opp. To Pl.'s Mot. For Summ. J., Ex. B, at 1). The plain language of the Subordination Agreement references and must be read in conjunction with the Amended and Restated Note and Warrant Purchase Agreement, which amended the Note and Warrant Purchase

Agreement, dated September 28, 2004. (See McCafferty Cert., Ex. B, at 2). The Amended and Restated Note and Warrant Purchase Agreement, the most controlling document executed in conjunction with the Subordination Agreement, distinguishes principal from interest throughout.

As a matter of contract interpretation, this issue boils down to meanings of “principal amount” as defined in Section 1 and the various “interest” terms set forth in Section 2.4 of the Amended and Restated Note and Warrant Purchase Agreement. Stonewall attempt to read contradictory meaning into certain terms set forth in Section 2.4. The Plaintiff claims that the ambiguity lies in the meaning of terms set forth in Section 2.4, including “PIK Interest”, “Basic Interest”, “Deferred Interest”, how these terms must be interpreted with Section 4.8 of the Subordination Agreement, and whether these terms show that NELS increased the principal amount in contravention of the loan agreements. As explained in more detail below, the terms contained in the Amended and Restated Note and Warrant Purchase Agreement are unambiguous. The applicable contractual provisions are not susceptible to competing interpretations with respect to the amount of the original “principal amount” and the later accrued “interest”; the unambiguous language of the loan agreements provide that the former is not inclusive of the latter.

When engaged in the process of contract interpretation, we must examine the plain language of the contract and, if the terms are clear, these terms should be given their plain, ordinary meaning. The record does not show that the parties intended any terms or provisions to have a technical, non-plain or non-ordinary meaning. Thus, the Court applies the plain, ordinary meaning of the following terms in accordance with the language and intent of the parties.

The Amended and Restated Note and Warrant Purchase Agreement defines “Principal Amount” as:

“Principal Amount” means, with respect to each Investor, the sum of the unpaid principal amount of all the Obligations owed to such Investor; provided, however, that if the “Principal Amount” applicable to all

Investors as calculated above is \$0, the “Principal Amount” shall instead mean, with respect to each Investor, the amount of all the Obligations then owed to such Investor.

(See McCafferty Cert. in Opp. To Pl.’s Mot. For Summ. J., Ex. C, at 12). The “Principal Amount” means the “unpaid principal amount”. The “Principal Amount” of the debt owed to the Senior Lenders, *i.e.*, the Senior Indebtedness, was \$4,500,000. Pursuant to this definition, the “Principal Amount” is never increased; the unpaid principal amount remains \$4,500,000. In actuality, the “principal amount” remains the same until it is paid off and the debtor satisfies its obligations to the lender. This concept is fundamental to any loan transaction. Thus, in the instant matter, the overall obligation owed to the investors, in this case the lenders, continues to accrue until the “principal amount” is paid; the accrual sum is in addition to and distinct from the original obligation. The plain language of the Subordination Agreement explicitly provides that the outstanding monetary obligation, *i.e.*, \$9,397,582, must be paid to the Senior Lenders. This outstanding monetary obligation accrued to \$9,397,582 as a result of the interest bearing on the unpaid principal, *i.e.*, \$4,500,000.

Next, the Court endeavors to read the definition of “Principal Amount” in conjunction with the various “interest” terms. The Amended and Restated Note and Warrant Purchase Agreement enumerates several definitions concerning “interest”, including “PIK Interest”, “Deferred Interest”, “Basic Interest” and “Interest Rate”, which are conspicuously separate and apart from the definition of “Principal Amount”. These interest terms are defined in the manner set forth in Section 2, and excerpted above in the “Factual Background” section of this opinion. At the time the Subordination Agreement was signed, the parties contemplated that there would be interest accruing on the Senior Indebtedness at varying rates. However, it was determined by the parties, based on the agreed-upon definition of “Principal Amount” that the interest would not be treated as principal. Although additional interest had accrued, that accrued interest is not included in the

“Principal Amount”. The only increase in the Senior Indebtedness constitutes accrued interest, which accrued on the outstanding principal amount when NELS failed to pay its Senior Lenders.

Stonewall’s reliance on Section 4.8 is misguided, as Stonewall fails to afford greater weight to the plain language of Section 2 of the Amended and Restated Warrant and Purchase Agreement and the parties’ understanding with respect to the construction of the subordination structure. As established herein, the Amended and Restated Warrant and Purchase Agreement provides the most current definitions and applicable terms of the contractual arrangement governing the parties. Section 2.4 states that a separate note is to be issued by NELS for interest that accrues on the Senior Indebtedness and if said notes are not issued, then the accrued interest becomes part of the principal of the debt due at maturity. In other words, the interest is simply tacked on or added to the principal amount at the time all outstanding obligations come due. There is nothing in the factual record or the supporting contract documents that supports Stonewall’s contentions.

When engaged in the process of contract interpretation, the court will strive to articulate an interpretation that fulfills the expectations of the parties, interprets the contract as written, and avoids writing a better contract than the one bargained for. Stonewall asks the Court to write a better contract than the one bargained for. Despite the certainty of the contractual terms, Stonewall seeks the imposition of a different interpretation as the basis to terminate the contract for NELS’ and thus now claim a material breach. The Subordination Agreement clearly indicates that the definition of “principal amount” is to be taken from the Note and Warrant Purchase Agreement, amended April 18, 2008. The Court can appreciate the frustration of Stonewall, which has not received payments from NELS on its loan in some time and will likely not receive payments in the near future given NELS’ default on the loans provided from the senior lenders. Nevertheless, the Court will not read into the contract inconsistent terms to benefit the subordinate party. For the foregoing reasons, the Court finds that the principal amount did not include interest and NELS

did not increase the original principal amount of \$4,500,000 to \$9,397,582 in contravention of the loan agreements. Therefore, summary judgment is awarded in favor of NELS.

a. Stonewall's Consent to the Increase of the Senior Indebtedness was Not Triggered.

Next, the Court disposes of Stonewall's argument that NELS increased the original principal amount of the Senior Indebtedness in contravention of the loan agreements; specifically, Stonewall contends that NELS' conduct triggered Section 4.8 of the Subordination Agreement. Stonewall argues that its consent to any increase in the Senior Indebtedness constituted to a prerequisite prior to increasing the original obligation of \$4,500,000 to \$9,397,582. Section 4.8 provides in pertinent part:

Notwithstanding the foregoing, and so long as any Subordinated Indebtedness remains unpaid, the Senior Lenders agree that they will not increase the principal amount of the aggregate facilities, as set forth in the Senior Lending Agreements on the date hereof, by more than \$1,000,000 without the prior written consent of Subordinated Lender, which consent will not be unreasonably withheld, conditioned or delayed.

(See Poe Cert. in Supp. of Pl.'s Mot. For Summ. J., Ex. G, at 9). In other words, if a party sought to increase the original principal amount of \$4,500,000 by more than \$1,000,000, *i.e.*, in excess of \$5,500,000, the terms of Section 4.8 obligated this party to obtain Stonewall's prior consent.

As established herein, the only increase in the Senior Indebtedness is the accrued interest. The parties contemplated that the interest on the principal amount would accrue and might eventually total an outstanding obligation in the amount of \$9,397,572. Specifically, Stonewall knew or should have known that the Senior Indebtedness would accrue interest if unpaid. Stonewall agreed to accept a promise of payment subordinate to another debt. The loan agreements provide that if the Senior Lenders were not paid, Stonewall could not be paid, and the outstanding obligation to the Senior Lenders would accrue interest as well. Thus, the substantial sum due and owing, which now totals \$9,397,582, did not trigger Stonewall's rights under Section 4.8. Section

4.8 did not obligate NELS to obtain Stonewall's consent with respect to accrued interest, as this was a natural and probable effect of the loan agreements. In a perfect world, NELS would have prospered and paid off all outstanding obligations to all parties, including the Senior Lenders and Stonewall. The economic downturn that precipitated this litigation should have been considered by the parties as a possible risk of loss. While the accrued interest undoubtedly affects Stonewall's prospects of future payment, the contract did imbue Stonewall with the right to avert accumulation of interest on the original debt amount of \$4,500,000. Thus, Section 4.8 was not triggered and NELS was not obligated to obtain Stonewall's consent prior to or while interest accrued.

b. Termination of the Contract is An Inappropriate Remedy.

Next, the Court disposes of Stonewall's argument that NELS' alleged material breach warrants termination and/or nullification of the Subordination Agreement and the related loan documents. Stonewall proposes that the only remedy available for the alleged breach of the Subordination Agreement is to nullify the entire agreement. NELS argues that termination or nullification contradicts the prescribed remedy provided in the Subordination Agreement and in law. Even if, *arguendo*, NELS breached its obligations under the loan agreements, termination or nullification of the entire contractual arrangement is unwarranted.

This concept is evidence by the plain language of the Subordination Agreement. Section 4.3 of the Subordination Agreement provides:

Survival Rights. The right of Senior Lenders to enforce the provisions of the Agreement shall not be prejudiced or impaired by any act or omitted act of the Borrower or Senior Lenders including forbearance, waiver, consent, compromise, amendment, extension, renewal, or taking or release of security in respect of any Senior Indebtedness by the Borrower with such provisions, regardless of the actual or implied knowledge of Senior Lenders.

(See McCafferty Cert., Ex. B, at 8). The language of the contract demonstrates that the parties intended that the acts of NELS or the Senior Lenders would not impair the rights of the Senior

Lenders to enforce the subordination. The parties did not enter into the loan arrangements with the expectation that the wrongdoing of one party effectively nullifies the obligations of every other party. Moreover, the Senior Lenders are not party to this action. Stonewall's requested remedy would effectively nullify the Senior Lenders' rights without affording them the opportunity to challenge the underlying claim and remedy. Therefore, Stonewall's claim that NELS's material breach warranted nullification and/or termination of the loan agreements fails.

Even if, *arguendo*, NELS breached the loan agreements, compensatory damages is the appropriate remedy in this case. Courts generally apply one of three remedies in breach of contract cases: restitution, compensatory damages, and performance. See Totaro, Duffy, Cannova & Co., L.L.C. v. Lane, Middleton & Co., L.L.C., 191 N.J. 1, 12-13 (2007) (quoting Donovan v. Bachstadt, 91 N.J. 434, 443-44, 453 A.2d 160 (1982)). "Compensatory damages put the innocent party into the position he or she would have achieved had the contract been completed." Lane, Middleton & Co., L.L.C., 191 N.J. at 12-13. When determining an award of contract damages, courts should consider what would fairly and reasonably be considered as either arising naturally in accordance with the parties' usual course of things, or in contemplation of both parties at the time they made the contract. See id. at 13 (citing Hadley v. Baxendale, 9 Exch. 341, 156 Eng. Rep. 145 (1854)); see also RST. 2d of Contracts, § 351 (2nd ed. 1981).

As stated in the previous subsection, the intended purpose of the Subordination Agreement establishes the reasonable expectation of the parties. Even if, *arguendo*, NELS breached the loan agreements at the expense of Stonewall, the alleged breach and recoverable remedy must be so construed to ensure preservation of the Senior Lenders' rights, who remain non-parties in this action. Thus, the Subordination Agreement must remain in place and the Senior Lenders must retain their seniority status. In accordance with the foregoing reasons summary judgment is granted in favor of NELS on this claim.



c. The Refinance of Senior Lenders' Debt Did Not Require Stonewall's Consent.

Next, the Court disposes of Stonewall's argument that the refinance of the Senior Lenders' debt required its prior consent. NELS argues that Stonewell, as a party to the Subordination Agreement, knew or should have known that the Senior Lenders and the Borrower possessed the contractual rights to modify and/or refinance the Senior Indebtedness. Stonewell contends that the Senior Lender and Borrower required the consent of Stonewall prior to refinancing.

The plain language of the contract does not obligate NELS to obtain Stonewall's consent to refinance the Senior Lenders' debt. Section 4.2 of the Subordination Agreement provides in relevant part that:

Additional Agreements. In the event that the Senior Indebtedness is refinanced in full, Subordinated Lender agrees at the request of such financing party to enter into a subordination and intercreditor agreement on terms substantially similar to this agreement.

(See Poe Cert., Ex. G, at 8). The plain language of this provision is unambiguous. Section 4.2 permits the parties to refinance the Senior Indebtedness, and at the request of the financing party, the Subordinated Lender will agree to enter into a subordination and intercreditor agreement on terms substantively similar to the Subordination Agreement. Conspicuously absent from this provision is the word "consent" or any phrase analogous to "consent". The Subordinated Lender's right to prevent the refinancing is subject to and limited by the request of the financing party and the terms of the new subordination and intercreditor agreement.

Similarly, Section 4.8 of the Subordination Agreement provides in relevant part:

Amendments to Senior Lending Agreements. Nothing contained in this Agreement, or in any other agreement or instrument binding upon any of the parties hereto, shall in any manner limit or restrict the ability of Senior Lenders from increasing or changing the terms of the loans under the Senior Lending Agreements, or to otherwise waive, amend or modify the terms and conditions of the Senior Lending Agreements, in such a manner as Senior Lenders and Borrower shall mutually determine. Each Holder of Subordinated Indebtedness hereby consents to any and all such waivers,

amendments, modifications, and compromises, and any other renewals extensions, indulgences, releases of Collateral or other accommodations granted by Senior Lenders to Borrower from time to time, and agrees that none of such actions shall in any manner affect or impair the subordination established by this Agreement in respect of the Subordinated Indebtedness. Notwithstanding the foregoing, and so long as any Subordinated Indebtedness remains unpaid, the Senior Lenders agree that they will not increase the principal amount...by more than \$1,000,000 without the prior written consent of Subordinated Lender, which consent will not be unreasonably withheld, conditioned or delayed.

(See Poe Cert., Ex. G, at 9). Clearly the plain language of Section 4.8 affords the Senior Lenders and Borrower the right to increase or change the terms of the loans under the Senior Lending Agreements in a manner that the Senior Lenders and Borrower mutually determine. In other words, the Subordinated Lender's rights are secondary and limited by the rights of these parties, who reserve the right to change the terms unilaterally and without input from the Subordinated Lender. The Subordinated Lender, Stonewall, is contractually obligated to *consent* to any waivers, amendments, modifications, and compromises, and any other renewals extensions, indulgences, releases of Collateral or other accommodations granted by Senior Lenders to Borrower, and *agrees* that these actions will not affect the subordinated status of the Subordinated Indebtedness pursuant to the Subordination Agreement. The only reference to "consent" that implies Stonewall's ability to thwart a unilateral change would be in its rights with respect to preserving the original principal amount; Stonewalls' consent is required if the parties increase this amount more than \$1,000,000.

Refinancing the Senior Indebtedness did not result in an increase of the principal amount by more than \$1,000,000. BLACK'S LAW DICTIONARY 1307 (8th ed. 2004) defines "Refinancing" as "[a]n exchange of an old debt for a new debt, as by negotiating a different interest rate or term or by repaying the existing loan with money acquired from a new loan." See BLACK'S LAW DICTIONARY 1307, "Refinancing" (8th ed. 2004). MERRIAM-WEBSTER DICTIONARY defines "refinance" as "to get a new loan to pay (an older debt)" or "to finance (something) again." See

MERRIAM-WEBSTER DICTIONARY, “Refinance”, (last accessed Feb. 2, 2016), <http://www.merriam-webster.com/dictionary/refinance>. To “refinance” a loan in the plain, ordinary sense of the word does not entail that the parties alter the principal amount. Rather, the principal amount remains the same, but the interest rate and/or monthly payment schedule changes. The factual record does not show that the parties altered the principal amount of \$4,500,000 when it refinanced the TD Bank North, N.A. debt. In exchange for refinancing the TD Banknorth debt, the Senior Lenders agreed to subordinate their rights in the Senior Indebtedness to the debt of Rockland Bank and Advantage Capital by virtue of loan agreements among the Senior Lenders, Rockland Bank, and Advantage Capital. Stonewall knowingly and voluntarily negotiated for this increased risk of loss exposure when it entered into the Subordination Agreement, which contained the refinancing provisions that were not conditioned on Stonewall’s consent. Therefore, Stonewall’s claim on the basis that NELS and the other parties refinanced the Senior Lenders’ debt in contravention of the loan agreements fails and summary judgment is granted in favor of NELS on this claim.

B. The Doctrine of Waiver is Inapplicable.

Next, the Court considers NELS’ argument that the doctrine of waiver is inapplicable and Stonewall’s claim that NELS’ waiver nullifies the Subordination Agreement, Promissory Note, and controlling subordination structure. Stonewall contends that NELS made several payments on the subordinated debt prior to and during the economic downturn and therefore, NELS impliedly waived the contractual provisions governing payment of the Subordinated and Senior Indebtedness. NELS asserts that it made payments to Stonewall as a courtesy, or as a tool to placate Stonewall.

Section 2.2 of the Subordination and Intercreditor Agreement specifically provides that “notwithstanding any other provision of the Subordinated Indebtedness to the contrary, any distribution with respect to the subordinated indebtedness is and shall be expressly junior and

subordinated in right of payment to all amounts due and owing upon all Senior Indebtedness[.]” (See McCafferty Cert. in Opp. To Pl.’s Mot. For Summ. J., Ex. B, Subsection 2.2, at 4). With few exceptions, the Subordination Agreement mandates that NELS, the Borrower, shall not make any distribution on the Subordinated Indebtedness until such time as a Senior Indebtedness shall have been paid in full.

Pursuant to Sections 2.2(a) and (b), NELS was permitted to pay and the holders of the subordinated indebtedness were permitted to receive certain distributions. Specifically, Section 2.2(a) permits the holder of the Subordinated Indebtedness to receive cash payments of principal and interest on the Subordinated Indebtedness, as well as reimbursement costs and expenses, collectively referred to as “Permitted Payments”. (See McCafferty Cert., Ex. B, Subsection 2.2(a), at 4). However, Section 2.2(b) specifically limits this permissible payment structure in the event of a default and provides that “following the occurrence of an event of default under the senior lending agreements the Borrower shall not make any Distribution on the Subordinated Indebtedness and no such Holder of Subordinated Indebtedness shall be entitled to receive or retain any such Distribution with respect to the Subordinated Indebtedness[.]” (See McCafferty Cert., Ex. B, Subsection 2.2(b), at 4-5).

In 2009, NELS suffered an economic downturn and was unable to pay the Senior Lenders or Stonewall. At that time, Section 2.2(b) of the Subordination Agreement mandated that NELS cease making payments to Stonewall. While the Senior Lenders initially permitted NELS to continue to make payments to Stonewall, their acquiescence ceased when NELS breached the financial covenants in the loan documents to Rockland Bank and Advantage Capital in April 2014. At that point, NELS could no longer make “courtesy” payments to Stonewall. Cessation of the payments was contemplated by the parties and memorialized in Section 2.2.

Stonewall misconstrues NELS' "courtesy" payments as a waiver in contravention of the plain language of the loan agreements. The plain language of the Subordination Agreement governs the applicability of the doctrine of waiver. Section 4.3 provides:

Survival of Rights. The right of Senior Lenders to enforce the provisions of this Agreement shall not be prejudiced or impaired by any act or omitted act of the Borrower or Senior Lenders including forbearance, waiver, consent, compromise, amendment, extension, renewal, or taking or release of security in respect of any Senior Indebtedness or noncompliance by the Borrower with such provisions, regardless of the actual or imputed knowledge of Senior Lenders.

(See McCafferty Cert., Ex. B, Subsection 4.3, at 8). The provision emphasizes the superiority of the Senior Lenders' contractual rights, which cannot be impaired or prejudiced by any subsequent waiver, even if the Senior Lenders have actual or imputed knowledge.

Additionally, Section 4.12 provides in pertinent part:

Binding Effect; Order. This Agreement shall be a continuing agreement, shall be binding upon and shall inure to the benefit of the parties...and their respective successors and assigns, shall be irrevocable and shall remain in full force and effect until the Senior Indebtedness shall have been satisfied or paid in full in cash...No action which Senior Lenders or Borrower may take or refrain from taking with respect to the Senior Indebtedness, including any amendments thereto which are not in violation of this Agreement, shall affect the provisions of this Agreement or the obligations of any Subordinated Lender hereunder. *Any waiver or amendment hereunder must be evidenced by a signed writing of the party to be bound thereby, and shall only be effective in the specific instance.*

(See McCafferty Cert., Ex. B, Subsection 4.12, at 12) (emphasis added). The plain language of Section 4.12 unambiguously requires that any waiver or amendment of the terms contained therein must be memorialized in a writing and agreed upon by the party seeking a waiver or amendment. The record does not evidence any writing, either formal or informal, in which the parties agreed to waive and/or amend the terms of the Subordination Agreement.

Even if, *arguendo*, the express language of the Subordination Agreement was inapplicable or ambiguous, Stonewall fails to demonstrate that the existence of a cognizable waiver under

common law. “Waiver ‘is the intentional relinquishment of a known right.’” Cnty. of Morris v. Fauver, 153 N.J. 80, 104 (1998) (quoting West Jersey Title & Guar. Co. v. Industrial Trust Co., 27 N.J. 144, 152, 141 A.2d 782 (1958)). “Waiver must be voluntary and there must be a clear act showing the intent to waive the right.” Id. “Waiver presupposes a full knowledge of the right and an intentional surrender; waiver cannot be predicated on consent given under a mistake of fact.” Fauver, 153 N.J. at 104-05 (internal citations omitted) (finding that plaintiff did not voluntarily and knowingly waive its right to complete payment under terms of contract where plaintiff was unaware of full rights supposedly waived and plain language of contract provided for full payment) (quoting West Jersey Title & Guar. Co., 27 N.J. at 153, 141 A.2d 782). A waiver must be made in exchange for valuable consideration, “or the act relied on as a waiver must be such as to estop a party from insisting on performance of the contract or forfeiture of the condition.” W. Jersey Title & Guar. Co. v. Indus. Trust Co., 27 N.J. 144, 152-53 (1958) (internal citations omitted).

In the instant matter, NELS asserts that it remitted payments to Stonewall as a “courtesy”. There is no evidence refuting this assertion. The record shows that Stonewall became increasingly frustrated with respect to NELS’ initial hesitation to remit payments given its financial constraints. Stonewall began to receive payments after expressing its frustrations to NELS. Stonewall, NELS, and the Senior Lenders voluntarily executed the subordination and loan documents, which contained the terms excerpted above. The record does not show that NELS intentionally, knowingly, and voluntarily sought to nullify the entire subordination structure without the consent of the Senior Lenders. The fact that NELS obtained consent of the Senior Lenders to remit payments to Stonewall shows that NELS intended to act within the constraints of the Subordination Agreement, which explicitly states that actual or imputed knowledge of the Senior Lenders of such conduct does not diminish their superior contractual rights. Furthermore, Stonewall did not provide NELS any valuable consideration in exchange for a waiver. Stonewall profited from

NELS' payments to the detriment of the Senior Lenders and yet, did not confer any benefit, pecuniary or proprietary, or assume additional or different contractual obligations in exchange for NELS' purported waiver. Moreover, NELS notified Stonewall that NELS could no longer afford to remit payments as early as 2009/2010. Nevertheless, Stonewall continued to accept payments, with knowledge of NELS' inability to pay and the contractual provisions prohibiting such payments at the expense of the Senior Lenders. Therefore, the doctrine of waiver is inapplicable in the instant matter and summary judgment is awarded in favor of NELS on this claim.

C. There was No Amendment to the Subordination Agreement or Promissory Note.

Next, the Court considers NELS' argument that Stonewall's affirmative defense, that the parties amended the loan agreements, must be dismissed for the same reasons stated above. Absent from the record is any written agreement, either formal or informal, that the parties intended to amend the terms of the Subordination Agreement or Promissory Note. Additionally, absent from the record is any clear, unequivocal, or decisive act of the parties to amend the terms of the Subordination Agreement or Promissory Note to the detriment of the Senior Lenders. The Promissory Note remains subject to the Subordination Agreement and the subordination structure governing the status of the parties remains intact. Therefore, Stonewall's claim predicated on the alleged amendment of the Subordination Agreement or Promissory Note fails and summary judgment is awarded in favor of NELS on this claim.

D. The Doctrine of Promissory Estoppel Is Inapplicable.

Finally, the Court considers NELS' argument that Stonewall's claim of promissory estoppel must be dismissed for similar reasons stated above. Stonewall contends that it relied on a supposed promise made by NELS that it would remit monthly payments to Stonewall in the sum of \$10,000. Stonewall thereby argues that NELS' counterclaim is barred by promissory estoppel. In its counterclaim, NELS seeks a declaratory judgment predicated on the assertion that it was not

obligated to remit payments to Stonewall pursuant to the Promissory Note in contravention of the Subordination Agreement, that it should be entitled to set-off the outstanding obligation due and owing, and that a constructive trust should be imposed on all monies paid by NELS to Stonewall for the benefit of the Senior Lenders.

The equitable doctrine of promissory estoppel is widely recognized in New Jersey. Section 90 of the Restatement of Contracts governs promissory estoppel and provides that:

A promise which the promisor should reasonably expect to induce action or forbearance on the part of the promisee or a third person and which does induce such action or forbearance is binding if injustice can be avoided only by enforcement of the promise. The remedy granted for breach may be limited as justice requires.

RST. 2d of Contracts, § 90(1) (2nd ed. 1981). To establish a *prima facie* claim of promissory estoppel, the aggrieved party must prove:

(1) a clear and definite promise by the promisor; (2) the promise must be made with the expectation that the promisee will rely thereon; (3) the promisee must in fact reasonably rely on the promise, and (4) detriment of a definite and substantial nature must be incurred in reliance on the promise.

Pop's Cones, Inc. v. Resorts Intern. Hotel, Inc., 307 N.J. Super. 461, 468-69 (App. Div. 1998).

“The essential justification for the promissory estoppel doctrine is to avoid the substantial hardship or injustice which would result if such a promise were not enforced.” See id. at 468-69 (citing Malaker Corp. Stockholders Protective Comm. v. First Jersey Nat’l Bank, 163 N.J. Super. 463, 484 (App. Div. 1978)).

Stonewall failed to establish a *prima facie* claim of promissory estoppel. Firstly, the record does not indisputably show that NELS made a clear, definite promise that it would pay Stonewall monthly installments of \$10,000 for an indefinite period of time. NELS’ decision to remit “courtesy” payments presupposed that no extenuating circumstances, *i.e.*, NELS’ default to its more senior lenders, would encumber its ability to remit the payments. Yet, Stonewall knew or



should have known that these extenuating circumstances could come to fruition and that it could suffer a potential cessation of “courtesy” payments. Stonewall was the assignee of the Promissory Note and as assignee, it was subject to the terms of the Subordination Agreement, which contractually subordinated Stonewall’s interests to the interests held by the Senior Lenders. Thus, any courtesy afforded to Stonewall remained subject to the controlling subordination structure.

In addition, the record does not show that when NELS remitted payments as a “courtesy” it expected Stonewall to somehow rely on such payments. Stonewall demanded and appropriated several payments at the expense and to the detriment of the Senior Lenders, with the knowledge that NELS faced economic hardship. As established herein, NELS did not intend to alter the written subordination structure or waive and/or amend the loan agreements with these gratuitous payments. NELS remitted these payments to placate Stonewall.

Furthermore, Stonewall did not in fact rely on NELS’ gratuitous conduct for the same reasons. NELS remitted payments to Stonewall as a “courtesy” and expressed no intention, in writing or orally, that it intended to alter the controlling contractual arrangement. Moreover, Stonewall did not suffer a detriment of a definite and substantial nature. Stonewall received monthly payments to the detriment of the Senior Lenders. Stonewall’s subordination status was not altered by these courtesy payments, as the subordination and loan agreements, under which Stonewall voluntarily consented to subordinated status, remained in force. In accordance with the foregoing reasons, Stonewall’s claim for promissory estoppel fails and summary judgment is granted in favor of NELS on this claim.

E. Indispensable Parties.

The Court finds moot NELS’ argument that summary judgment should not be awarded in Stonewall’s favor on the basis that the Senior Lenders constitute indispensable parties and must be joined in this action. At oral argument, the parties agreed that the Court may decide the pending

motions for summary judgment and dispose of the case even though the Senior Lenders have not been joined. In accordance with the foregoing reasons, NELS' argument that joinder of the Senior Lenders is necessary is now moot.

F. Attorney's Fees.

The Court will not award attorney's fees in this matter.

**CONCLUSION**

The plain language of the Subordination and related loan agreements clearly demonstrates that NELS did not materially breach the terms of these agreements in the manner alleged by Stonewall. Therefore, termination and/or nullification of the Subordination Agreement, Promissory Note, and related loan agreements is unwarranted in the instant matter. In addition, it is clear from the plain language of the Subordination Agreement, Promissory Note, and related loan agreements, as well as the factual record, that NELS did not intend to waive, amend, and/or nullify the controlling subordination structure between the parties and as such, any statutory or common law claim of waiver, amendment, or promissory estoppel is inapplicable here.

Therefore and in accordance with the foregoing reasons, summary judgment is awarded in favor of the Defendant NELS.

It is so ordered.