

Non-Recourse Carveouts

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Non-Recourse Loans

- Lender agrees to look only to the collateral for repayment in the event of a default
- May be described as non-recourse to both borrower and guarantor or as fully recourse to SPE borrower and limited recourse to guarantor.
- Sample non-recourse language:

Notwithstanding any provision in the Loan Documents to the contrary, except as set forth in subsections (b) and (c), if Lender seeks to enforce the collection of the Debt, Lender will foreclose the Security Instrument instead of instituting suit on the Note. If a lesser sum is realized from a foreclosure of the Security Instrument and sale of the Property than the then outstanding Debt, Lender will not institute any Proceeding against Borrower or Borrower's general partners, if any, for or on account of the deficiency, except as set forth in subsections (b) and (c).

Carveouts

- Carveouts are the exception to this non-recourse/limited liability limitation
- Probably the most misunderstood concept in commercial loans
 - Non-recourse carveouts cover more than “bad boy” acts
 - Scope/risk is deal specific
 - Each lender has its own set of carveouts, but the basic structure of each is the same

Original Scope

- Original focus of carve outs in non-recourse loans: The borrower's "bad conduct."
 - Fraud.
 - Misapplication of insurance proceeds or condemnation awards.
 - Waste of the real property collateral.
 - Environmental matters.

Current Trend

- Beyond bad conduct, carveouts tend to also address:
 - Matters diminishing or eroding the value of the collateral.
 - Destruction of the collateral.
 - External risks affecting the collateral.
 - Controls over behavior of the borrower which may adversely affect the collateral or the lender.
 - Protecting the lender against the need for additional investment in the collateral.

Above the Line

- “Above the Line” or “Loss Liability” carveouts are matters for which there is personally liability to the lender to the extent of the loss incurred by the lender as a result of particular event occurring.
- Examples include:
 - Misappropriation of rents
 - Security deposits
 - Paying taxes and insurance

Below the Line

- “Below the Line” or “Full Liability” carveouts are matters for which the borrower and guarantor will be personally liable for the full amount of the debt as a result of particular event occurring.
- Examples include:
 - Bankruptcy
 - Unpermitted transfers

Above the line examples

- Misappropriation of rents
- Misappropriation of security deposits
- Failure to pay taxes or insurance
- Failure to turnover insurance or condemnation proceeds
- Waste and/or failure to maintain the property
- Removal of personal property without replacement
- Costs of environmental cleanup
- Unintentional misrepresentation

Below the line examples

- Voluntary bankruptcy
- Involuntary bankruptcy
- Fraud
- Failure to give lender access to property or provide reports
- Unpermitted transfers
- Contesting foreclosure or appointment of receiver
- Violation of SPE covenants

Carveout Negotiation Basics

- Moving items above the line
- Tightening language
- Conforming lender form language to the deal

Moving items above the line

- Many lenders will not accept deletion of below the line carveouts, but there may be some the lender is willing to move above the line.
- Remember that an “above the line” carveout can still result in full liability.
- For example:
 - failure to permit inspections or provide reports
 - fraud or intentional misrepresentation by Borrower in connection with the making of the Loan

Tightening language

- Many carveouts begin with broad, somewhat ambiguous language
- For example:
 - all losses suffered and liabilities and expenses incurred by Lender relating to waste on the Property
 - all losses suffered and liabilities and expenses incurred by Lender relating to any unintentional misrepresentation set forth in any Loan Document

Conforming lender form language to the deal

- Often negotiated provisions of the loan documents merit revision to recourse carveouts
- For example:
 - failure of a Loan Party to maintain adequate property and liability insurance on the Property
 - failure of a Loan Party to pay all taxes and assessments on the Property when due

Potential Pitfalls

- Overlapping carveouts
- Relationship between the borrower and the guarantor
- Relation to environmental indemnities
- Carveouts that make broad reference to other sections of the loan agreement and/or to defined terms
 - SPE covenants
 - Transfer restrictions

Cases

- *Weinstein v. Park Funding Corp.*, 879 P.2d 462 (Colo.App. 1994) – specific recourse carveout provisions are enforceable in Colorado
- *Heller Financial, Inc. v. Lee*, 2002 WL 1888591 (N.D. Ill., August 16, 2002) – liens filed against property without borrower's actual knowledge still give rise to liability under carveout
- *D.A.N. Joint Venture v. Binafard*, 116 Fed.Appx. 93 (9th Cir. 2004) (not published in Federal Reporter) – failure to maintain property where there was substantial income from the property can constitute waste
- *LaSalle Bank N.A. v. Mobile Hotel Properties, LLC*, 367 F. Supp. 2d 1022 (E.D. La. 2004) – amendment to LLC agreement without lender consent violated SPE requirements and triggered full recourse

Cases (cont'd)

- *111 Debt Acquisition Holdings, LLC v. Six Ventures Ltd*, 413 Fed. Appx. 824 (6th Cir. 2011) (not published in Federal Reporter) – borrower bankruptcy not properly authorized and to which guarantor objected still triggered full recourse
- *Wells Fargo Bank v. Cherryland Mall Ltd. Partnership*, 812 N.W.2d 799 (Mich.Ct.App. 2011) – failure to remain solvent breached SPE covenant, which in turn tripped full recourse carveout [legislatively overruled in Michigan]
- *U.S. Bank National Association v. Green Meadows SWS LLC*, 9. N.E. 3d 433 (Ohio 2014) – full recourse liability for failure to satisfy all financial reporting requirements
- *CSFB 2001–CP–4 Princeton Park v. SB Rental 1, LLC*, 980 A.2d 1 (N.J. Super. Ct. App. Div. 2009) – unpermitted subordinate financing, paid off before the default on the senior loan, still triggered full recourse

Cases cont'd

- *J.E. Robert Co. v. Signature Properties, LLC*, 2010 WL 796774 (Conn. Super. Ct. 2/3/10) – termination of a parking license was an unpermitted “transfer” triggering full recourse
- *FDIC v. Prince George Corporation*, 58 F.3d 1041 (4th Cir. 1995) – contesting foreclosure an enforceable recourse carveout giving rise to full liability