

CLIENT ALERT

Court gives New Twist to Enforcement of Springing Guaranty

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On August 11, 2009, the Appellate Division of the Superior Court of New Jersey affirmed the enforceability of a non-recourse carve-out provision relating to the lien of commercial real property by a second mortgage absent the first lender's prior written consent. **CSFB 2001-CP-4 Princeton Park Corporate Center, LLC v. SB Rental I, LLC**, Docket No. A-6307-07T2 (NJ App. Div. 2009). Note that the carve-out provision enforced by the Court rendered the subject loan full recourse to the borrower and guarantors and was not merely a claim, damage or loss carve-out.

BACKGROUND

On May 2, 2001, Credit Suisse First Boston Mortgage Capital, LLC loaned to SB Rental I, LLC the original principal amount of \$13,300,000.00 (the "**Loan**"). The Loan was evidenced by a mortgage note (the "**Note**") and secured by a first mortgage encumbering certain real property located in South Brunswick, NJ (the "**Property**"). The Loan was also secured by a guaranty (the "**Guaranty**") executed by three (3) individuals (collectively the "**Guarantors**"). The Loan was a non-recourse loan subject to non-recourse carve-out provisions contained in the Note and Guaranty. The Note contained the following carve-out provision:

Notwithstanding anything to the contrary in this Note or any of the Loan Documents . . . (B) the Debt shall be fully recourse to Maker in the event that . . . (iii) Maker fails to obtain Payee's prior written consent to any subordinate financing or other voluntary lien encumbering the Mortgaged Property *(Emphasis added)*

The Guaranty contained the following carve-out provision:

Notwithstanding anything to the contrary in any of the Loan Documents . . . (ii) Guarantor shall be liable for the full amount of the Debt in the event that . . . (C) Borrower fails to obtain Lender's prior written consent to any subordinate financing or other voluntary lien encumbering the Mortgaged Property *(Emphasis added)*

Subsequently and absent consent of the Lender, Borrower obtained an additional \$400,000.00 mortgage loan from another lender L.G. Financial Consultants, Inc. which was secured by a second mortgage on the Property (the "**Second Mortgage Loan**"). According to the Loan Documents, Borrower thereby triggered the aforementioned non-recourse carve-out provision in the Note and Guaranty rendering the Loan fully recourse to both Borrower and Guarantors.

The Second Mortgage Loan was paid off on or about December, 2004, seven (7) months after it was obtained. However, a discharge of the second mortgage was not timely recorded with the county clerk.

In May of 2006, Borrower failed to make its monthly debt service for the Loan due to in part, the loss of its sole tenant, and failed to make any subsequent principal or interest payments. Lender instituted a foreclosure action, which Borrower did not appear, resulting in the Lender obtaining a foreclosure judgment March 28, 2007. The Property was then sold at a Sheriff's Sale.

Thereafter, the Lender sought a deficiency action against Borrower and Guarantors for the remaining balance of the Loan. Lender moved for summary judgment, seeking full recourse liability against Borrower and Guarantors based on the Second Mortgage Loan being obtained absent Lender's consent. Borrower and Guarantor opposed the summary judgment motion arguing that the Lender was not harmed by the Second Mortgage Loan and therefore the carve-out provision was an unenforceable penalty.

COURT RULING

The lower court found in favor of the Lender and concluded that the damages sought by Lender were not speculative nor estimated, but actual and fair, and that the carve-out provision addresses liability rather than damages. Thus, a judgment in the amount of \$5,195,932.72 was entered against both Borrower and Guarantors.

The Appellate Division of the Superior Court of New Jersey affirmed the lower court's decision and concluded that the non-recourse provision was clearly written and negotiated between parties. Further, the court found that the carve-out clause is not a liquidated damages provision because the clause operates to define personal liability and not affix probable damages, and it provides for only actual damages. The actual damages being the amount remaining on the Loan. Further, the court determined that it was not relevant that Borrower cured the breach that triggered Borrower and Guarantors' personal liability under the Note and Guaranty (i.e. full repayment of the Second Mortgage Loan) because this was their bargained for provision. Also it was not relevant that the Lender did not suffer any damages. The court cited with approval the following line of cases. *Blue Hills Office Park LLC v. J.P. Morgan Chase Bank*, 477 F. Supp. 2d 366, 377-383 (D. Mass. 2007)(transfer of mortgaged property without lender's consent and various other conduct rendered the borrower and guarantors fully liable for a loan deficiency); *First Nationwide Bank v. Brookhaven Realty Assocs.*, 223 A.D.2d 618, 637 N.Y.S.2d 418 (N.Y. App. Div.), appeal dismissed, 88 N.Y.2d 963, 647 N.Y.S.2d 715, 670 N.E.2d 1347 (1996)(bankruptcy filing not dismissed within 90 days of filing triggered recourse liability under a loan carve-out provision); and *FDIC v. Prince George Corp.*, 58 F.3d 1041, 1045-1050 (4th Cir. 1995)(recourse liability affirmed where the borrower filed a bankruptcy petition in violation of a carve-out provision).

Because of the parties involved and the importance of the appellate court's decision, an appeal filed with the New Jersey Supreme Court is likely.

For more information, please contact the professional(s) listed below, or your regular Crowell & Moring contact.