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CLIENT ALERT

"CONNECTICUT ENFORCES FULL RECOURSE CARVE-OUT"

Date: March 16, 2010
Issue: Enforceability of a non-recourse carve-out provision in Note and Guaranty

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On February 3, 2010, the Superior Court of Connecticut upheld the enforceability of a non-recourse carve-out provision in a Note and Guaranty pertaining to an unapproved transfer (more specifically, the early termination of a Parking License Agreement). *J.E. Robert Company et al. v. Signature Properties, LLC et al.*, 2010 WL 796774 (Conn.Super. 2010). It is important to note that the carve-out provision enforced by the Court rendered the Loan ***fully recourse*** to the Borrower and Guarantors and was not merely a claim, damage or loss carve-out.

FACTS:

On April 13, 2005, JPMorgan Chase Bank, N.A. (the "**Original Lender**") granted a mortgage loan to Signature Properties, LLC (the "**Borrower**") in the original principal amount of $8,800,000.00 (the "**Loan**"). The Loan was evidenced by a Fixed Rate Note (the "**Note**") and secured by a first Mortgage and Security Agreement (the "**Mortgage**") encumbering commercial property located in New London, CT (the "**Property**"). The Loan was also secured by a Guaranty (the "**Guaranty**") executed by four individuals (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:

> in the event . . . of a breach or default under Sections 4.3. or 8.2 of the [Mortgage] . . . the limitations on recourse set forth in this Subsection 10(a) will be null and void and completely inapplicable, and this Note shall be with full recourse to [Borrower]. *(Emphasis added)*

Section 8.2 of the Mortgage provided that Borrower shall not, "without the prior written consent of Lender, Transfer the Property or any part thereof or permit the Property or any part thereof to be Transferred." "Transfer" was defined in the Mortgage to mean "any voluntary or involuntary sale, conveyance, mortgage, grant, bargain, encumbrance, pledge, assignment or transfer of all or any part of the Property or any interest therein . . . ."

The Guaranty provided that the Guarantors "absolutely, irrevocably and unconditionally guarantee to Lender (and its successors and assigns), jointly and severally, the payment and performance of the Guaranteed Obligations . . . ." Further, the Guaranty provided that if the recourse provision in the Note are triggered, "then the Guaranteed Obligations shall also include the unpaid balance of the Debt."

At the time of the Loan origination, Original Lender required Borrower to enter into a Parking License Agreement (the "**Parking Agreement**") with 280 Atlantic Street, LLC ("**280 Atlantic**"), which permitted Borrower and its tenants to utilize the parking area located on a parcel of land located across a public road from the Property (the "**Parking Lot**"). The Parking Agreement was executed on April 9, 2005 (four days before the loan was closed) and was effective as of January 1, 2002. The Parking Agreement allowed the Borrower and its tenants to park 120 vehicles on the Parking Lot. The Parking Agreement had an initial term of seven (7) years (which commenced January 1, 2002), and had two (2) renewal options, each for five (5) year terms.

280 Atlantic and Borrower were affiliated entities. Two of the Guarantors (the "**Julians**") owned 50% of Borrower and the same Guarantors owned 50% of 280 Atlantic. The Julians were also the managing members of 280 Atlantic and Borrower.

Approximately, four (4) months after the closing of the Loan, the Julians, through any entity known as Julian Investments, LLC ("**Investments**") entered into negotiations to lease property for a Walgreens' Pharmacy. In November of 2005, Investments purchased property adjacent to the Parking Lot (the "**Acquisition Parcel**") and entered into a lease with Walgreens. The Walgreens' lease required Investments to construct a building on the Acquisition Parcel and a portion of the Parking Lot.

In October 2006, Borrower and 280 Atlantic agreed to terminate the Parking Agreement as of December 31, 2006 (two years before the end of the initial term). Borrower did not obtain the lender's consent to terminate the Parking Agreement.

The Property complied with the municipal parking requirements without the existence of the Parking Agreement. Apparently, the Parking Agreement was initially provided to satisfy parking requirements of a tenant at the Property; however, as of December 31, 2006, this tenant was no longer leasing space at the Property.

In April of 2007, Borrower failed to make its monthly interest payment required under the Note and the Borrower made no subsequent debt service payment.

On January 29, 2005, the Loan was sold into a securitization trust and assigned to LaSalle Bank National Association, as trustee. In October of 2007, the Loan was further assigned to Shaw's New London, LLC (the "**Holder**").

The Holder filed a foreclosure suit through is first amended complaint dated March 4, 2008. Then, the Holder moved for summary judgment for the foreclosure, a declaratory ruling that the Note is a full recourse obligation, and an order that the Guarantors satisfy the unpaid amounts under the Note.

The Holder sought summary judgment for recourse liability against Borrower and Guarantors based on the termination of the Parking Agreement being a "Transfer" under the Mortgage that was made without the lender's prior written consent. Borrower and Guarantor opposed the summary judgment motion for full recourse liability arguing, among other things, that the termination of the Parking Agreement was not a "Transfer" under the Mortgage and therefore the full recourse provision in the Note and the Guaranty were not triggered. It should be noted that the Borrower and Guarantor didn't dispute the fact that an event of default occurred under the Note and Mortgage because of the numerous missed debt service payments.

COURT HOLDINGS:

The Court reviewed the definition of "Property" under the Mortgage (which included the Land, improvements erected or located on the Land, and all agreements, contracts and licenses respecting or pertaining to the use and operation of the Property). It was determined by the Court that the definition of "Property" under the Mortgage was broad enough to include the Parking Agreement because it was a license related to the operation of the Property.

Then, the Court reviewed the definition of Transfer set forth in the Mortgage along with definition of "transfer" in Black's Law Dictionary (7th Ed.1999). The Court determined that a "transfer" is "any mode of disposing of or parting with an asset or an interest in an asset . . . The term embraces every method-direct or indirect, absolute or conditional, voluntary or involuntary-of disposing of or parting with property or with an interest in property . . . To convey . . . from . . . one person to another; to pass or hand over from one to another."

The Court concluded that the Parking Agreement was an asset of Borrower and the early termination of the Parking Agreement by Borrower, effectively transferred or conveyed Borrower's rights under the Parking Agreement back to 280 Atlantic. As such, a transfer of the Property occurred without the consent of the lender resulting in a breach of Section 8.2 of the Mortgage. Therefore, the full recourse provision in the Note and Guaranty was triggered and the Court held the Guarantors jointly and severally liable for the outstanding amount of the Loan.