

**“BAD BOY” GUARANTIES: CAN A “GOOD BOY”
BECOME PERSONALLY LIABLE?**

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I. INTRODUCTION

Full-recourse loans, once a staple of commercial lending, have largely disappeared during the past decade, and non-recourse loans became the norm as banks found ways to minimize their risks.¹ The investment banks that originate many of the non-recourse loans felt comfortable with the arrangement because they typically packaged these loans into commercial mortgage backed securities, or CMBS, and sold them as bonds, reducing their own risk if the borrowers could not pay.² In addition, in an era of increasing property values, the lenders could reasonably expect to collect on the loans by resorting to the underlying collateral, as long as the borrower did not act in any way to forestall the foreclosure or dissipate the collateral.

To address the problem of potential “bad acts” by the borrower, lenders increasingly sought to carve out such acts from the otherwise non-recourse promissory notes or in the form of separate “non-recourse carve-out” or “bad-boy” guaranties.³ Since most real estate projects are encapsulated in special purpose entities (SPEs) with few assets other than the property itself, the guaranties would be executed by the presumably deep-pocket owners of the SPE.

In *Heller Financial v. Lee*, 2002 WL 1888591 (N.D. Ill. 2002), the court described the rationale of non-recourse carve-outs as follows:

[N]onrecourse loans create issues in terms of the motivation of borrowers to act in the best interest of the lender and the lender’s collateral. As a result, lenders identified defaults that posed special risks and carved them out of the general nonrecourse provision. These carve-outs provide the protection that lenders require, personal liability, to insure the incentive to repay the loan and maintain the viability of the collateral.

These “bad boy” guaranties are intended to cover a limited spectrum of events within the guarantors’ control as managers of the properties, such as fraud, misapplication of funds, misappropriation of collateral, or fighting the lender’s right to foreclose by, for instance, filing for bankruptcy and asserting automatic stay. However, the scope of such guaranties can be as

¹ Lingling Wei, *Guarantee Gamble: Developers Dread Return of Recourse*, WALL STREET JOURNAL, June 18, 2008. A loan is “non-recourse” where the debtor “is not personally liable for the debt upon default, but rather, the creditor’s recourse is solely to repossess the property granted as security for the loan.” *Heller Financial v. Lee*, 2002 WL 1888591, at * 4 (N.D. Ill. 2002).

² Lingling Wei, *Guarantee Gamble: Developers Dread Return of Recourse*, WALL STREET JOURNAL, June 18, 2008.

³ Such guaranties are commonly referred to as “bad-boy,” “non-recourse carve-out,” “limited recourse,” and “springing” guaranties. Such terms are used interchangeably in this article.

narrow or as broad as the parties desire. **Exhibit A** contains a representative sample of carve-outs that might be encountered in a typical bad-boy guaranty.

One potential issue that can arise in connection with such carve-outs is the possibility of guarantors losing managerial and perhaps even economic control of their projects, while remaining liable for the full amount of the loan under the “bad boy” guaranties. Two particular situations pose a special danger: 1) mezzanine loan arrangements, and 2) properties with more than one investor, typically held in a limited liability company (LLC), where the LLC operating agreement (or a separate agreement) contemplates a “changeover” (replacement of the managing member) or a “buyout” (acquisition of member’s stake in the company) upon occurrence of certain events.

Mezzanine Loans. Developers have to be particularly careful in structuring guaranties when the project involves a first-lien mortgage loan with a carve-out guaranty by the developer, combined with a mezzanine loan secured by a pledge of equity interests in the borrower SPE. This particular structure might easily turn a non-recourse mezzanine loan into a full-recourse one, contrary to the developer’s expectations.

A default on a mezzanine loan can lead to mezzanine lender foreclosing on its collateral; namely, the equity interest of the developer in the borrower entity. As a result, the mezzanine lender obtains full control over the borrower, including the ability to commit the “bad acts” that would trigger the bad-boy guaranty. The developer, having lost both its economic interest and managerial rights in the borrower entity, nonetheless remains fully liable under the guaranty. At this point, the mezzanine lender can threaten to commit a “bad act” and trigger the guaranty. Faced with the risk of being personally liable under the bad-boy guaranty of a senior mortgage loan, the developer might find itself incentivized to repay the smaller mezzanine loan to dissuade the mezzanine lender from committing the “bad acts.” Effectively, a non-recourse mezzanine loan becomes a full-recourse obligation.⁴

“Changeover” and “Buyout” Clauses in LLC Agreements. A similar loss of control might occur where an LLC operating agreement contains a “changeover” or a “buyout” clause. Changeover clauses provide for removal of the managing member of a multi-member LLC for “cause.” Such causes range from fraud, gross negligence, and intentional misconduct in the management of an LLC to failure to make a required capital contribution, a vote by the majority of non-managing members, or a filing of bankruptcy petition by the managing member (the enforceability of this last provision in the context of an LLC agreement is questionable). In any event, the managing member, while not losing its economic stake in the project, has to cede control to another member.

⁴ A discussion of this particular situation also appears in Robert S. Insolia, Jeremy A. Litt, *Beware Unintended Personal Liability On Mezzanine Debt*, NEW YORK LAW JOURNAL, March 24, 2003.

A buyout provision or a separate buy/sell agreement permits one member to buy out the economic interest of another member at a price determined by an agreed-upon formula and under specified-upon conditions. An example of a condition triggering the buyout clause is deadlock among members on a decision that has to be approved unanimously or by a majority of the votes. Clearly, the effect of such buyout is that the member being bought out loses its economic stake, and, by implication, its managerial role.

The complications from such provisions can be substantial. Consider this modified real-world example. Two investment funds each form a subsidiary (Sub A and Sub B). The subsidiaries form an LLC, and, in the summer of 2008, acquire a mixed-used condominium project in a major metropolitan area that was recently built but is now being sold at a 30% discount due to the collapse in sales of condo units and the overall economic conditions. Sub A gets a 60% interest in the LLC, and Sub B gets a 40% interest. The LLC then gets a loan from the Big Bank. Sub A is the initial managing partner, and it also provides a bad-boy guaranty to the Big Bank, which is triggered, among other things, if the LLC files for bankruptcy. Fast-forward six months. The sales have stalled, and the values have dropped below the parties' worst-case projections. Sub A and Sub B disagree on the proposed strategy for the development and reach a deadlock, which triggers both the buyout and the changeover clauses in the LLC operating agreement. Moreover, due to certain assumptions in the buyout formula, the price for Sub A's stake is set at pennies on a dollar. To add insult to injury, Sub A remains liable under the bad-boy guaranty, and Sub B, once it takes over, has an incentive to put the project into bankruptcy, trigger the guaranty, and have the lender collect the entire amount from Sub A (the hypothetical jurisdiction does not have a statute requiring the lender to foreclose on the collateral first). In this scenario, the unsuspecting Sub A loses its economic interest, and still has to come up with the money to repay the Big Bank's loan.

II. ENFORCEABILITY OF “BAD BOY” GUARANTIES

Are bad-boy guaranties enforceable? As the decisions below suggest, the courts have generally ruled favorably to lenders in enforcing non-recourse carve-outs, including bad-boy guaranties, in accordance with their stated terms. That said, there is at least one plausible defense that has not yet been tested in court – those guaranties that trigger full recourse upon bankruptcy filing by the borrower might not be enforceable as impermissible *ipso facto* clauses. In *Brookhaven Realty* and *Prince George*, discussed immediately below, the courts enforced such guaranties, but in both cases *after* the bankruptcy case was terminated. It is unclear if similar result would be reached in a bankruptcy court. In *Heller Financial*, the court dismissed a challenge to a non-recourse carve-out as a penalizing liquidated damages clause. The significance of *Heller* is that the court upheld lender's recourse for the entire amount of deficiency, as opposed to just the damages proximately caused by the “bad act.” *Blue Hills* is the first case to uphold bad-boy *guaranties*, as opposed to non-recourse carve-outs in *mortgage agreements*.

Some commentators suggest that in the cases that have been decided to date, borrower conduct may have been viewed as a factor in undermining a particular property's performance and that this dynamic might change in an environment in which lenders might be viewed as equally or even more culpable for deteriorating economic conditions that have led to a spike in loan defaults.⁵

a. First Nationwide Bank v. Brookhaven Realty Associates⁶

A typical bad-boy guaranty is triggered by a bankruptcy filing of the borrower. Section 365 of the Bankruptcy Code, however, provides that after the commencement of the case, an executory contract or any right or obligation under such contract cannot be terminated or modified solely because of a provision in such contract conditioned on the insolvency of the debtor or the commencement of a case. Such clauses are known as *ipso facto* clauses, and the first challenge to a bankruptcy-triggered carve-out as an impermissible *ipso facto* clause was raised in *Brookhaven*.

The guaranty in *Brookhaven* was a fairly standard carve-out to an otherwise non-recourse mortgage agreement between the plaintiff, First Nationwide Bank, and the defendant Brookhaven Realty Associates. It provided that Brookhaven and its individual partners would not be personally liable in the event of a default except under certain conditions. One such condition occurred if a bankruptcy proceeding was commenced by or against Brookhaven and that proceeding was not dismissed or otherwise resolved within 90 days of its filing so as to permit the Bank to exercise its security interest in the property.

When Brookhaven defaulted on its mortgage, the Bank sued it for fraud in obtaining the loan, and also commenced an action to foreclose on the property. Brookhaven filed a voluntary bankruptcy petition, that was not dismissed until well after the 90-day period set forth in the non-recourse agreement had expired. Following the dismissal of the bankruptcy proceeding, the Bank sought a determination in the foreclosure action that it was entitled to a deficiency judgment against Brookhaven and its individual partners. The Bank's motion for summary judgment was granted, and the defendants appealed.

On appeal, the court held that *after* the bankruptcy proceeding is terminated, the enforceability of an *ipso facto* clause is no longer governed by the Bankruptcy Code, but should be determined by state law (in this case New York law) and the contract between the parties. This holding is consistent with the legislative history, contained in the Senate and House reports, that specifically provides that such clauses "are not invalidated *in toto*, but merely made

⁵ Charles S. Ferrell, Jeffrey S. Thiede, *Time to Think About Your Real Estate Loan Guaranty*, Faegre & Benson LLP Client Alert, March 5, 2009, available at: <http://www.faegre.com/showarticle.aspx?show=9026>

⁶ *First Nationwide Bank v. Brookhaven Realty Associates*, 223 A.D.2d 618 (N.Y. App. Div. 1996).

inapplicable during the case for the purposes of disposition of the executory contract or unexpired lease.” Sen. Rep. 95-989; House Rep. 95-595.

The court, however, went further, and stated in dicta that even assuming that the Bankruptcy Code applies post-termination, a mortgage is not an “executory” contract, and, therefore, a non-recourse carve-out triggered by bankruptcy is not defeated by section 365(e) of the Code. This dicta suggests that the clause could be enforceable in bankruptcy.

b. Federal Deposit Insurance Corporation v. Prince George Corporation⁷

In *FDIC v. Prince George Corp.*, the court enforced a bankruptcy-contingent carve-out provision of a promissory note. In that case, a joint partnership and one of the partners executed a \$17.5 million promissory note in favor of the lender to finance the development of a resort community in coastal South Carolina. The note was secured by the mortgage on the real estate to be developed and was non-recourse, except that the non-recourse provision did not apply “to the extent that” the lender’s right of recourse to the property was “suspended, reduced or impaired by or as a result of any act, omission or misrepresentation... or as a result of any case, action, suit or proceeding” voluntarily initiated by the borrower.

Eventually, the borrower defaulted on the loan, and the lender became insolvent and was taken over by the Federal Deposit Insurance Corporation (FDIC). Thereafter, the borrower, Prince George Joint Venture (PGJV), and the partner, Prince George Corporation (PGC), filed a lawsuit seeking to enjoin FDIC from foreclosing on the property. When a summary judgment was granted in favor of FDIC, and the FDIC filed a foreclosure action, the borrower parties vigorously opposed the foreclosure with numerous motions designed to stall the proceedings. When these tactics did not succeed, PGC filed an involuntary bankruptcy petition against PGJV. A month later, the bankruptcy court lifted the stay and dismissed the bankruptcy petition. The sale took place and the FDIC made the high bid on the property.

Following a prolonged foreclosure process, FDIC filed a motion for a deficiency judgment against PGC claiming that resisting the foreclosure action and filing the bankruptcy petition triggered the recourse provisions in the note. PGC argued that resisting the foreclosure was not an “act” triggering the carve-out, and filing a bankruptcy petition was a protected statutory right, the waiver of which was void as against public policy. On appeal, the court dismissed both of these arguments. Specifically, the court rejected the claim that the provision in the nonrecourse note acted to waive the right to file bankruptcy and was contrary to public policy: “This argument ignores the fact that the note did not prohibit [the joint venturer] from

⁷ *Federal Deposit Insurance Corporation v. Prince George Corporation*, 58 F.3d 1041 (4th Cir. 1995).

resorting to bankruptcy; it merely provided that if [the joint venturer] took certain actions it would forfeit its [contractual] exemption from liability for any deficiency.”⁸

Interestingly, the court interpreted liability “to the extent” PGC’s actions impaired or suspended FDIC’s recourse rights to mean “during the time” FDIC’s recourse rights were impaired. Under this interpretation, PGC was not liable for the balance due on the note after foreclosure, but only for any loss caused directly by its “acts.” The court calculated such damages by applying interest at the rate prescribed in the note to the entire balance on the note during the delay. The damages also included taxes and costs and attorney’s fees incurred by the lender due to the delay.

Notably, in *Prince George*, as in *Brookhaven*, the bankruptcy proceeding had been dismissed prior to the initiation of the lawsuit enforcing the carve outs. Thus, the court did not consider the enforceability of this provision in bankruptcy.

c. **Heller Financial, Inc. v. Lee**⁹

In *Heller*, the court dismissed a challenge to a full-recourse carve-out of the non-recourse promissory note as an impermissible liquidated damages clause, and allowed the lender to collect the full amount of deficiency following a foreclosure, and not just the damages caused by the “bad boy” behavior of the defendants.

The loan in question was a \$9,900,000 second loan (on top of the \$34,200,000 primary loan) to a limited partnership formed by the defendants in order to acquire a hotel in Orlando, Florida. The loan was secured by a pledge of the defendants’ equity interest in the hotel. A promissory note executed in connection with the loan was non-recourse, but it also included a carve-out provision holding the borrowers personally liable for the repayment of the loan if they granted or permitted the filing of any lien or encumbrance on the collateral without the written consent of the lender.

In the first five months of operation, six tax and mechanics’ liens, totaling over \$820,000, were placed on the property. The lender, Heller, gave a notice of default, declared the entire indebtedness under the promissory note due and payable, and held a public sale of the equity interest securing the note. Thereafter, it sued the individual defendants for the deficiency.

The court applied Illinois law, and dismissed the defendants’ argument that the bad-boy carve-out — which triggered liability for the entire amount of deficiency (the amount is not specified in the opinion), and not just the damages (presumably, the \$820,000 in liens) — was a liquidated damages provision unenforceable as a penalty. First, the court noted that the

⁸ *Id.* at 1046.

⁹ *Heller Financial, Inc. v. Lee*, 2002 WL 1888591 (N.D. Ill. 2002).

defendants knew and agreed to the carve-out, as illustrated by the fact that one of the non-defendant partners had bargained for and was excluded from personal liability under the carve-out. Second, the court noted that any lien placed on the property directly subtracts from the defendants' equity interest, thus damaging the lender's collateral. Third, the court held that the full-recourse liability was not a liquidated damages provision because it provided for only actual damages suffered by the lender, even if such damages exceeded the amount of the liens. Thus, the defendants were personally liable for the repayment of the loan.

The fact that the collateral in question was an equity interest that was immediately impaired by the placement of liens suggests that a different conclusion could have been reached had a similar carve-out appeared in the first mortgage, secured by the property itself. Under that scenario, a junior lien would not impair the mortgage, and a senior lien would merely have the potential, but would not necessarily jeopardize recovery, of the collateral so long as an appropriate equity cushion remained.

d. Blue Hills Office Park LLC v. J.P. Morgan Chase Bank¹⁰

The significance of *Blue Hills* is that it is the first reported decision where a court enforced a “bad boy” non-recourse carve-out *guaranty* against principals of a borrower. The guarantors in this case formed Blue Hills, a special-purpose limited liability company, to refinance the mortgage on a property they owned in Massachusetts. They obtained a non-recourse loan from Credit Suisse for \$33 million, secured by a mortgage on the property.

Several years after the mortgage closed, the owner of an adjoining property commenced renovation and applied to the zoning board for a special permit to construct a parking garage. Blue Hills objected that the garage would block the views from its office building and reduce its value, but the zoning board granted the permit. Blue Hills appealed, and, eventually, settled with the neighbor for \$2 million. Simultaneously, Blue Hills became aware of a major tenant's decision not to renew its lease and to relocate to the newly renovated neighbor's property. Thus, Blue Hills could no longer obtain the necessary funds to pay the real estate taxes. The borrowers never notified the lender of the litigation or the settlement. Instead, the borrowers transferred settlement proceeds into their private account.

The lender was not happy to find out that the principals pocketed the \$2 million instead of making it available to the borrower to pay the mortgage. The lender sued, and the court enforced the “bad-boy” guaranty against the guarantors. The guaranty provided that the guarantor “shall be liable for the full amount of the Debt” in certain events, including failure to obtain Lender's prior written consent to any assignment, transfer, or conveyance of the mortgaged property or any interest therein, and failure to maintain a single-purpose entity status of the borrower.

¹⁰ *Blue Hills Office Park LLC v. J.P. Morgan Chase Bank*, 477 F. Supp. 2d 366 (D. Mass. 2007).

The court found that the guarantors breached each of these provisions. First, the court held that the settlement was part of the collateral because it was based on a cause of action related to, derived from, and used in connection with the mortgaged property. Blue Hills' standing to bring the suit against the neighbor derived from its ownership of the mortgaged property. Therefore, the guarantors transferred mortgaged property without obtaining the lender's consent. Second, the guarantors failed to maintain the special-purpose entity status of the borrower by commingling property that belonged to the borrower – the \$2 million settlement - with other funds in their personal account. Third, the borrowers failed to maintain their single-purpose entity status because Blue Hills' "independent director," who once worked as a secretary at the guarantors' law firm and did not participate in the management of Blue Hills, was not a "participating independent director." Thus, the court held that the guarantors were liable under the bad-boy guaranty for the *full amount* of deficiency following a foreclosure, for pre-judgment interest, and for attorneys' fees and costs in the combined amount of over \$17 million.

III. LENDERS BEWARE

As mentioned above, the courts have not yet been called upon to rule on the enforceability of *ipso facto* clauses in bad-boy guaranties in a pending bankruptcy case. One commentator warned that lenders should not assume that *Brookhaven* and *Prince George* will protect the bad-boy guaranty from attack on grounds of inconsistency with federal bankruptcy policy:¹¹

While both of these cases enforced bankruptcy-contingent liabilities, they should provide little comfort to lenders. In each case, the bankruptcy proceedings had been dismissed prior to the initiation of the guaranty suit, making these poor candidates to test the robustness of springing guaranties in the face of a strong bankruptcy policy argument. Moreover, both decisions involved single-asset realty cases, meaning that the borrowers had few, if any, creditors other than the mortgagee. As a result, state law fiduciary duties that might have been owed to creditors were not relevant either.

The guaranties may also be challenged on other grounds, and while so far the courts have been resistant to upholding public policy over the clear language of the contract, a different set of facts might lead to a different holding. For instance, one commentator has suggested that bad-boy guaranties may be challenged as an unenforceable waiver of an LLC member's fiduciary duty owed to the entity by creating a conflict of interest situation.¹²

¹¹ Marshall E. Tracht, *Will Exploding Guaranties Bomb?*, 117 BANKING L.J. 129, 131 (Mar./Apr. 2000).

¹² Marshall E. Tracht, *Will Exploding Guaranties Bomb?*, 117 BANKING L.J. 129, 132-4 (Mar./Apr. 2000).

Springing guaranties may also be challenged on public policy grounds or as penalizing liquidated damages under contract law, to the extent that the guaranty is triggered by a minor violation that results in full recourse instead of recourse to the extent of loss caused by the particular act.¹³ This may be particularly true where there is no connection between the triggering event and the amount of deficiency the guarantors would have to pay the lender. In *Blue Hills*, for instance, a violation of single-purpose entity status was found where the borrower failed to have an independent director. However, in certain circumstances, such violation alone would have no practical impact on the lender, and yet may trigger full recourse under a multi-million dollar guaranty. Whether such potentially draconian outcome is an unenforceable penalty remains to be seen.

IV. HOW “GOOD BOYS” CAN PROTECT THEMSELVES

For guarantor or member of an LLC that wants to ensure that his or her “good” behavior will avoid personal recourse, the first consideration in drafting a non-recourse carve-out guaranty is determining who, when, and how much. Who is going to provide the guaranty? When will it be triggered? Should it emphasize broad parameters for what constitutes an impermissible act or should it have a specific list? Should it be limited to the amount of damages resulting directly from “bad acts” or should the lender be entitled to collect the entire amount of deficiency on the loan? Should there be a cap on damages? Taking a cue from *Blue Hills*, the parties could negotiate to limit the bad-boy liability to direct damages (\$2 million), to the full amount of deficiency (\$17 million), or cap the damages at a certain value, such as \$5 million. Considering these issues in advance will help the guarantor or LLC member evaluate the scope of his or her liability.

Next, the guaranty must address the possibility of the guarantor losing control over the project, either through the foreclosure of the mezzanine loan described above or because of the ouster as a managing member under the LLC operating agreement. The simplest solution is to provide in the guaranty itself that it automatically terminates when the guarantor loses its managerial power or economic control over the borrowing entity. Such provision may be acceptable to the lender because, in such circumstances, the guaranty no longer serves the original purpose for which it was intended of creating a disincentive for the guarantor to commit acts that are damaging to the lender’s rights or its collateral.

Alternatively (or in addition), modifications can be made to the mezzanine loan documents or the LLC operating agreement. With mezzanine financing, the guarantor needs to address two potential outcomes: where the mezzanine lender takes over the equity interest and

¹³ Harris Ominsky, *Mortgages: Personal Liability Despite Non-Recourse Clause*, 37 REAL ESTATE LAW REPORT 4, February 2008.

where the equity interest is sold to an unrelated third party. To obtain protection in the first case, the guarantor should negotiate for an indemnity from the mezzanine lender that would cover any recourse liability under the senior nonrecourse carve-out guaranty that is triggered by a bad act that occurs after the foreclosure of the pledged mezzanine equity interests, and is not caused by the original guarantor.

To prevent incurrence of personal liability for “bad acts” committed by the ultimate third-party buyer of the equity interests, the mezzanine pledge agreement can also expressly condition the right to foreclose on the occurrence of one of the following two events. First, a sale of mezzanine interests to a third party buyer should be permissible only if that buyer provides an indemnity for liability arising out of its own “bad acts” and the original guarantor approves the financial condition of the third-party buyer under the “reasonable satisfaction” standard. Second, such foreclosure should be permitted only where a third-party buyer agrees with the first-lien lender to substitute the original guarantor.

Finally, in case of a changeover or buyout provision in the LLC agreement, where the first-lien lender is unwilling to provide for an automatic termination of the guaranty upon change of control, the guarantor should carefully review the indemnity provision in the LLC operating agreement and ensure that it indemnifies the guarantor for any “bad acts” committed by the new managing member following a buyout, a changeover, or the loss of managerial control by the guarantor for any reason.

All of the above steps can help “good boy” guarantors and LLC members avoid recourse liability for the “bad acts” of other parties.

EXHIBIT A: REPRESENTATIVE NON-RECOURSE CARVE-OUT PROVISIONS

Note: these are for illustration purposes only, and some of the provisions might overlap and cover the same category of “bad acts”

MOST COMMON CARVE-OUTS

- Voluntary filing of a bankruptcy petition or failure to dismiss an involuntary bankruptcy petition within a specified period (e.g., within 90 days);
- Violation of the due-on-sale clause;
- Voluntary placement of liens or encumbrances on the property or failure to contest and remove involuntary liens and encumbrances within a specified period;
- Failure to get lender’s prior written consent to any subordinate financing, other liens or encumbrances.
- Transfer of property or interests without prior written consent of the lender;
- Contesting the lender’s foreclosure action; initiating a lender liability lawsuit; asserting any defenses, claims, or counterclaims in foreclosure, foreclosure-related, or deficiency actions; taking any action to frustrate, delay, or prevent the lender’s exercise of default remedies.
- Fraud or material misrepresentations by borrower, principal or any officer, director, partner, member or employee of borrower in connection with the application for or creation of the indebtedness or any request for any action or consent by lender;

OTHER CARVE-OUTS

- Failure to maintain insurance on the property;
- Failure to pay taxes;
- Environmental contamination of the property;
- Failure to properly maintain the property;
- A breach of representations regarding hazardous materials;
- Failure to pay, when due, the first full monthly payment of principal and interest under the note;
- Failure to transfer to lender upon demand and after an event of default, of all rents and security deposits collected by borrower from tenants;
- Failure to apply all insurance and condemnation proceeds as required by the mortgage;
- Failure to comply with sections of the mortgage relating to the delivery of books and records, statements, schedules and reports;
- Borrower’s acquisition of any property or operation of any business not permitted by transfer provision of the mortgage;

A more detailed discussion of why lenders perceive some carve-outs to be more important than others can be found in Portia Owen Morrison and Mark A. Senn, *Carving Up the “Carve-Outs” in Nonrecourse Loans*, 9 PROBATE & PROPERTY 8 (May/June 1995).