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### **"Springing Recourse" for Breach of a "Bad Boy" Non-Recourse Carve-Out Provision Upheld in New Jersey**

In the current environment, both lenders and borrowers find themselves looking very closely at the various "non-recourse carve-out" provisions in their otherwise non-recourse real estate loan documents. Of particular interest, of course, are the so-called "springing recourse" provisions (providing for full recourse to borrower, and in some cases guarantors, in the event of the occurrence of certain prohibited events). A recent case is of significant interest in the foregoing regard (we are grateful to Professor Patrick Randolph of the University of Missouri - Kansas City School of Law, for bringing this case to the attention of the wider legal community).

In a recent decision, the Appellate Division of the Superior Court of New Jersey held that a springing recourse provision (for impermissibly encumbering the property) was enforceable against a borrower and the loan guarantors, despite some creative arguments that the carve-out was an unlawful liquidated damages provision that was meant to penalize borrower and that lender was not harmed by borrower's breach (*CSFB 2001-CP-4 Princeton Park Corporate Center, LLC v. SB Rental I, LLC, et. al.* A-6307-07T2, 2009 WL 2431530. (N.J. Super. App. Div.; August 11, 2009)). Although this particular holding is from New Jersey, it is worthy of attention as the reasoning applied by the Court may well also be applied by courts in other jurisdictions to uphold the application of such provisions.

The New Jersey court upheld enforcement of a non-recourse carve-out provision that had been triggered by borrower's prohibited procurement of subordinated financing. Although the subordinated financing had been paid off well before the payment default on the senior loan that led to foreclosure, the Court upheld application of the springing recourse, rendering borrower and guarantors responsible for a \$5.2M deficiency judgment. Borrower and guarantors opposed such relief, on the grounds that lender had not been harmed by the encumbrance, the breach was unrelated to any damages suffered by lender and therefore the carve-out clause was an unenforceable punitive liquidated damages provision. The trial and appellate courts rejected these arguments, concluding that the carve-outs to the non-recourse status of the loan do not affix particular damages, but rather they define the terms and conditions of personal liability and are therefore not liquidated damages clauses (so there is no analysis needed of the reasonableness of the damages). The Court went on to state that non-recourse carve-out provisions cover defaults that lender has identified as posing a special risk to lender and therefore it is irrelevant whether the breach was cured and whether or not lender was harmed.

In reaching their conclusion the Court cited a case from New York, in which recourse had been triggered under a provision that provided for springing recourse in the event of a bankruptcy filing not dismissed within 90 days. In that case, the petition was subsequently dismissed, but *after* the expiration of the 90-day period, but the Court upheld that this "cure" was ineffective to avoid recourse liability.

Presumably, if this New Jersey court is presented with a similar case involving liability of guarantors for “springing recourse on bankruptcy,” other things being equal, it is likely to reach the same conclusion and uphold the provision.

The case is significant as it was a case of first impression in New Jersey and the Court followed the precedent of other courts in finding a non-recourse carve-out to be valid and enforceable. Further, the Court here specifically rejected treating this “bad boy” carve-out as a penalty or subjecting it to a liquidated damage analysis.

## Firm Facts

Duval & Stachenfeld is proud to announce three new partners – Samuel Lee, Michael Kupin and Lance Levine, who each have joined the real estate department. Samuel Lee was a former partner in the highly-regarded real estate practice group of Thacher Proffitt & Wood LLP, specializing in the representation of lenders in various finance transactions. Lance Levine was a former member of Cozen O'Connor, who has represented financial institutions such as HSBC Bank USA, Goldman Sachs Credit Partners, Lehman Brothers and RAIT Financial Trust in many sophisticated lending transactions. Michael Kupin was a former senior counsel with the boutique capital markets lending firm, Brown Raysman Millstein Felder & Steiner LLP and most recently with Paul, Hastings, Janofsky & Walker L.L.P.

Messrs. Lee, Kupin and Levine each have substantial real estate lending experience encompassing first mortgage lending, mezzanine lending and securitized lending, and also loan workouts, restructurings, acquisitions and dispositions. Their presence significantly expands the Firm’s capabilities in the real estate lending area.

If you have a need for legal advice on any distressed real estate matters, please contact any of the following partners in our [Distressed Real Estate](#) Group:

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