PUBLICATION

NY Court Rejects Recourse Triggers Accepted in *Cherryland* and *Gratiot*

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In a prior post ("Emerging Statutory Threats to Recourse Triggers"), we tackled Michigan and Ohio statutes that invalidated non-recourse triggers sprung by certain types of insolvency events. As noted there, the statutes were motivated by two Michigan decisions, *Wells Fargo Bank, N.A. v. Cherryland Mall Limited Partnership*, 812 N.W.2d 799 (Mich. Ct. App. 2011) and *51382 Gratiot Avenue Holdings, LLC v. Chesterfield Development Company, LLC*, 835 F. Supp. 2d 384 (E.D. Mich. 2011), which had permitted recourse based on "insolvency", including the non-payment of the loan debt itself. The Michigan and Ohio statutes now bar these types of recourse triggers.

A recent New York case analyzed similar issues. In *U.S. Bank National Association v. Rich Albany Hotel, LLC*, 2013 NY Slip Op. 52141(U) (N.Y. Sup. Ct. Dec. 16, 2013), the plaintiff sought recourse liability against a borrower and guarantors based on various springing recourse events. The loan agreement provided for recourse if there occurred certain listed "event[s] of default," including a default based on the borrower not "paying its debts as they become due." The plaintiff argued that "debts" included the loan debt itself. The New York court disagreed. While the court conceded that the plaintiff's reading was literally correct, it nonetheless concluded that "[s]uch a construction . . . completely nullifies the non-recourse structure of this loan." Accordingly, the court interpreted "debts" narrowly to refer only to the debts owed to other parties. Based on this reading, recourse was not triggered. Similarly, the plaintiff argued that the borrower, by missing its debt payments, failed to maintain its status as a "Single Purpose Bankruptcy Remote Entity" because (in part) it did not "remain solvent" by "maintain[ing] adequate capital in light of its contemplated business operations." Again, the court rejected this argument by interpreting "debt" to refer to debts other than the loan debt. On these points, *Rich Albany Hotel* sharply conflicts with *Cherryland Mall* and *Gratiot Avenue* but generally comports with the effects of the Michigan and Ohio statutes.

In addition, it is also worth noting that the court rejected several other grounds for recourse liability as well. First, the court found that, under the terms of Loan Agreement, the placement of a junior lien on the collateral was not sufficient trigger recourse liability as an unpermitted "transfer". Second, the Court held the entry and docketing of the judgment, though perhaps violating the single purpose bankruptcy remote entity requirement not to incur other "indebtedness," could not be invoked because, among other things, the plaintiff failed to demonstrate compliance with the Loan Agreement's notice requirements for this type of default.

In short, there are two central lessons to draw here. The first, demonstrated by state statutes and *Rich Albany Hotel*, is that lenders will have a difficult time enforcing recourse triggers premised on nothing more than non-payment of the debt itself. The second lesson is to ensure that your own notice obligations are complied with for each default alleged.