A Victory For Lenders – “Full Recourse” Clauses Will Be Enforced!

The Central District of Illinois’ opinion in *U.S. Bank National Association v. Springfield Prairie Properties, LLC* confirmed a significant victory for lenders who make nonrecourse loans with “full recourse” carve-outs. The *Springfield Prairie Properties* Court found that after the borrower defaulted on its nonrecourse mortgage loan, the borrower’s subsequent actions triggered a provision which automatically made the loan full recourse and immediately payable. Specifically, after the borrower defaulted, it failed to obtain the lender’s written consent before it transferred rental income (collateral) from the property into trust accounts of their attorneys. The Court determined that these actions triggered a provision under the note which converted the nonrecourse obligation into a full recourse obligation, thus requiring both the borrower and the guarantor to pay the lender more than $34 million. Including such provisions in a nonrecourse loan affords lenders additional security from unscrupulous borrowers/guarantors who attempt to move collateral out of the reach of their lender(s) after defaulting.

On October 11, 2012, and for months to follow, Springfield Prairie Properties, LLC (“Borrower”) and Robert W. Egizii (“Guarantor”), failed to make required loan payments, thus defaulting on a $20 million nonrecourse mortgage loan. After default, the Borrower, without the lender’s written consent, completed a series of transfers, sending approximately $3 million in rental income from the collateral property to various trust accounts of their lawyers, thus placing the collateral out of the lender’s reach. After learning of these transfers, the lender accelerated the loan and demanded payment in full from both the Borrower and Guarantor. The lender relied on a provision in the note (and a similar provision that incorporated it into the guaranty) that stated that the Borrower is personally liable to the lender for the full amount due if the Borrower fails to obtain lender’s prior written consent to any assignment, transfer or conveyance of the property or any interest therein as required by the underlying mortgage.

The Borrower and Guarantor argued that a much broader provision in the note allowed them to make the transfers if the funds were applied to the ordinary and necessary expenses of owning

and operating the property. The Borrower and Guarantor maintained that the post-default transfer of rental income was used to pay their legal counsel, an ordinary and necessary expense of owning property. Further, the Borrower and Guarantor argued that the provision relied upon by the lender conflicted with this much broader provision.

The Court first concluded that the two provisions set forth in the note did not contradict each other. The Court noted that they are separate provisions addressing different situations – (i) a full recourse event if the Borrower does not obtain lender's consent before transferring property; and (ii) recourse only as to the amount of funds that were not used to pay ordinary and necessary expenses of owning and operating a property (a "springing recourse event"). The notes allowed the lender to pursue both remedies simultaneously.

The Court made three factual findings regarding the events which triggered the full recourse obligations: (i) a transfer occurred; (ii) the transfer was of property as defined by the mortgage; and (iii) the lender did not consent to these transfers. Because of this finding, the Court stated that it did not matter if the funds were used to pay ordinary and necessary expenses of owning and operating the property.

The Court sent a clear message to lenders and nonrecourse borrowers alike – "full recourse" carve-out provisions set forth in notes and guaranties will be enforced. As the Court concluded in its opinion, there is nothing absurd about a nonrecourse loan becoming recourse upon the occurrence of a triggering event.

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