

**INDUSTRY DEFENSE FUND
APPLICATION FOR FUNDS**

TO: BOMA IDF Oversight Committee

FROM: BOMA of Metropolitan Detroit

RE: 1. BOMA Efforts Supporting Michigan's Nonrecourse Mortgage Loan Act --
Prohibiting and Invalidating Post Closing Solvency Covenants in Nonrecourse Loans
2. Michigan Court of Appeals Amicus Brief (on Remand from the Michigan Supreme
Court) Defending the Constitutionality of Michigan's Nonrecourse Mortgage Loan Act
3. Additional Efforts and Briefing

AMOUNT: \$30,000

DATE: February 25, 2013

I. PURPOSE:

BOMA Metro Detroit requests funding up to \$30,000 to file an amicus brief in the Michigan Court of Appeals (on Remand from the Michigan Supreme Court) in support of Michigan's Nonrecourse Mortgage Loan Act, which is currently under attack, and to file an anticipated additional brief in the Michigan Supreme Court (pending the outcome in the Court of Appeals). The cost of both appeals is capped at \$15,000.

The Michigan Court of Appeals' decision in Wells Fargo Bank, NA v Cherryland Mall Limited Partnership et al, 295 Mich App 99, 812 NW2d 799 (December 27, 2011), ("*Cherryland*") dangerously threatens to make every CMBS loan fully recourse whenever the borrower is underwater. The Court found a way, not contemplated by the Borrower or the Lender at the time of the loan, to change a loan from "non-recourse" (no guaranty and secured only by the mortgage on the property) to a "recourse loan" in which there would be personal liability.

Cherryland filed an application for leave to appeal the Court of Appeals decision to the Michigan Supreme Court and BOMA (with the help of the IDF) filed an Amicus in that appeal joining in the request for a reversal in light of the detrimental effect that the *Cherryland* decision could have around the country.

While the appeal was pending, BOMA went into action to see if a legislative remedy to this problem was possible. Indeed, the Michigan Court of Appeals acknowledged that its interpretation of the common contract language in so-called nonrecourse CMBS loans "seems incongruent with the perceived nature of a nonrecourse debt" and may result in an "economic disaster for the business community in Michigan." However, it declined to consider public policy ramifications upon noting that "it is the role of the Legislature to address matters of public policy."

BOMA and its Michigan members leaped into action and urged the Michigan Legislature to enact the Nonrecourse Mortgage Loan Act (the Act). The legislation passed by overwhelming, bipartisan majorities of 35-7 in the Senate and 97-12 in the House. It declared post-closing solvency covenants in nonrecourse mortgage loans invalid and unenforceable as an unfair and deceptive trade practice. It also specifically made the Act retroactive so that it applied to all loans in existence on March 26, 2012 and all cases that had not yet resulted in a final and non-appealable judgment.

Following the Legislature's action, Defendants-Appellants filed a motion with the Supreme Court to vacate this Court's decision on the basis of the Act. In lieu of granting Defendants-Appellants' pending application for leave to appeal, the Supreme Court issued its order on September 26, 2012 remanding this matter to this

Court for reconsideration of its December 27, 2011 decision in light of the Act. 2012 Mich LEXIS 1646, 820 NW2d 901 (2012). Because the Act applies retroactively, the Lender has argued that the Act is unconstitutional as violative of the Contract Clause's prohibition against state laws impairing contractual rights.

The Act has importance and impact well beyond the parties in the *Cherryland* case. It means a lot to BOMA, commercial real estate interests and all of their related industries. That was the very reason that BOMA made a significant investment in time and effort, human and financial resources in leading the way to the Act's passage, especially in record time. It is largely because of its passage that the threat of deficiency collection litigation against borrowers and guarantors in otherwise nonrecourse loans was virtually eliminated. The most helpful aspect of this legislation was its retroactive effect—that it applies to all such loans already in existence on the date of the Act.

The commercial real estate industry is at risk that what BOMA fought so hard to obtain and did obtain at substantial expense could still be lost in the courts. Unless the constitutionality of the Act is upheld at this stage (and perhaps the next if the decision of the Court of Appeals is again appealed to the Michigan Supreme Court), a great portion of the value of the legislation to the industry is at risk.

A previous request for funding for the Amicus Brief in support of the application for leave to appeal to the Michigan Supreme Court was submitted on February 8, 2012 and was granted. That application contains additional background information related to the underlying court cases and is incorporated herein by reference.

II. MEMBER IMPACT:

A: Please indicate the number of BOMA members that will be impacted by the proposed action. For example, "All BOMA members in the City of Los Angeles or LA County, or all BOMA members in the State of Texas".

The issues presented in this appeal could impact *every BOMA member* that has a CMBS loan on its portfolio or any of its buildings and believes that the loan is non-recourse. Michigan's Nonrecourse Mortgage Loan Act, if sustained on appeal, can serve as model legislation to protect similarly situated Borrower and Guarantors around the country. If the retroactivity of the Act is found unconstitutional, then continuing involvement remains essential in order to continue the fight to reverse the decision and holding of the *Cherryland* case on the merits of the case and not merely as invalidated by the Act.

Over the past decade, lenders have made \$1 trillion in securitized loans, known as CMBS loans, to the owners of commercial real estate under standardized loan documents. These CMBS loans were underwritten, marketed, sold and documented on the explicit basis that they were non-recourse, which meant that the borrowers had no personal liability for the debt. Instead, a CMBS lender's sole remedy was to take back the property in the event the borrower became insolvent (i.e., the property income could not service the debt), and the lender was prohibited under the loan documents from obtaining a money judgment for any deficiency.

This non-recourse feature of a CMBS loan was its central attraction. The only limited exception to this non-recourse feature typically were in narrow circumstances where personal liability was imposed on the borrower for bad conduct commonly referred to as bad boy acts. One typical bad-boy act was a borrower's failure to maintain its status as an SPE that owned and operated a single asset. A CMBS loan usually required the borrower to maintain its SPE status as the owner and operator of a single asset so that its assets would be isolated from other entities; thereby reducing the risk that the borrower's financial situation would be adversely affected by the bankruptcy of an affiliated entity, person or business.

One of the covenants appearing in just about every one of these sorts of loans states that the borrower shall not become insolvent. (Generally, the borrower will not let its liabilities exceed its assets and/or will pay its debts as they become due. This depends on state law as to the exact definition).

With the substantial drop in property values beginning in 2008 due to the illiquidity that gripped the commercial real estate market, many borrowers under commercial loans became insolvent as their property values became substantially less than their loan balances (again, this depends on state law as to the exact definition). And, since the borrowers were structured to own only one asset –the commercial property mortgaged to secure the loan – it is obvious that this sort of insolvency would occur.

However, it was never the intention of the draftsman of these covenants to trap a borrower and its guarantors into a recourse loan in this fashion. The sole recourse on failure of a CMBS loan was for the lender to foreclose the mortgage and take the property. It is well outside the scope and contemplation of all the parties to these loan transactions for the guarantors to be liable on the "no insolvency" covenant. It is not the fact of an insolvency that would ever trigger recourse, but only if the insolvency is caused by a bad act. If mere insolvency can trigger full recourse, then virtually every loan with a so-called bad boy carve out guaranty would in fact be a full recourse loan.

The Legislature's enactment of the Nonrecourse Mortgage Loan Act effectively stabilized the CMBS financing industry and avoided anticipated additional lawsuits. Although the Legislature's enactment of Nonrecourse Mortgage Loan Act calmed the turmoil within the commercial real estate financing market at least temporarily, that unrest continues to simmer below the surface. The Lender and Borrower communities around the country are closely watching this case. The filing of more *Cherryland* style lawsuits is being held in abeyance pending the outcome of the Courts' decision on the Nonrecourse Mortgage Loan Act.

Thus, this matter is of extreme significance to BOMA as many loans taken out by BOMA members will have this issue.

B: Please also indicate any regional or nationwide impact to BOMA members.

This issue will have a regional and nationwide impact on BOMA members for the aforementioned reasons. BOMA members have hundreds of millions of dollars, if not billions of dollars, in CMBS loans with lenders potentially lying in wait to spring "recourse" based on mere insolvency without any "bad act" whatsoever.

III. BOMA MEMBERS' INTERESTS IMPACTED:

In the space provided, please indicate which specific member interests will be impacted through this project. Examples might include private property rights, need to maximize return on investment, secure fair tax treatment, etc. Please reference all applicable BOMA policy statements, and list all interests that would be impacted using additional sheets if needed and attach supplemental materials if appropriate.

1. Assure that if loans go into default because of the insolvency of the particular Borrower/Property Owner caused by a diminution of property values, increase in vacancy rates or others reasons not the result of a "bad boy" act of the Borrower, that a loan does not suddenly become a full recourse, fully guaranteed loan.
2. Assure that the understanding of loan agreement language at the inception of a loan transaction remains consistent throughout.
3. Protect investor interests as investors may have invested funds believing that their liability is limited to their contribution and that there was no other liability in the absence of fraud or other bad acts – insolvency not being one of them, since that is always a risk.

IV. PRECEDENT VALUE:

Has this issue been litigated, legislated, or the subject of regulation in another local or state jurisdiction, or at the federal level?

NO

YES.

The issues presented in this appeal could impact every BOMA member that has a CMBS loan on its portfolio or any of its buildings and believes that the loan is non-recourse. Michigan's Nonrecourse Mortgage Loan Act, if sustained on appeal can be model legislation to protect similarly situated Borrower and Guarantors around the country. If the retroactivity of the Act is found unconstitutional, then continuing involvement remains essential in order to continue the fight to reverse the decision and holding of the Cherryland case on the merits of the case and not merely as invalidated by the Act.

V. MATCHING FUNDS:

In completing this section, please refer to the Application Process and Disbursement of Funds sections of the IDF Rules. The leveraging of additional funds to defend the industry's interests is a key goal of the IDF. Please indicate the amounts and specific source(s) of funds you are dedicating to this issue.

BOMA Metro Detroit is actively soliciting funds to support this effort. It still has substantial outstanding obligations related to the successful efforts in the Michigan Legislature that culminated in the passage of the Nonrecourse Mortgage Loan Act. The present Amicus Brief is a necessary part of protecting the investment that has been made to date.

VI. ACCOUNTABILITY:

A. Please provide the following information on the individual who will serve as lead on this project and will verify all relevant payment requests.

Janet Langlois, Executive Director, BOMA of Metro Detroit
38800 Country Club Drive
Farmington Hills, MI 48331
248-848-3714
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BOMA Metro Detroit will serve as the lead. Expenditure of any of these funds will be subject to the three-signature requirement contained in the BOMA IDF Rules.

B. How will project costs be tracked, and how will the required updates, financial statements, and related documentation outlined in the Disbursement of Funds process (Section VII of the IDF Rules) be provided to the IDF Oversight Committee?

The contracted legal firm that will be engaged for this assignment will be required to agree to a budget and a fee cap. Invoices for legal services will be reviewed by the BOMA of Metro Detroit's Executive Director and the Co-Chairs of the Government Affairs Committee for accuracy and reasonableness. No requests for payment will be submitted except through the BOMA Metro Detroit, which will have reviewed the billings and submitted them with a recommendation for payment. BOMA of Metro Detroit will comply with all applicable IDF Rules in connection with the process.

All expenditures will be made via invoice and reviewed prior to reimbursement by BOMA's Advocacy Division, as well as the Finance staff. Also, no funds will be expended until approved by the IDF Chair and BOMA's President.

VII. DURATION OF FUNDING:

IDF funds are available for 12 months following the authorization of disbursements. Please indicate the time table for resolution of this issue, including when disbursement of funds will be expected.

Due to an expedited briefing schedule, the Amicus Brief for which funding is being sought has already been filed. At the time of the briefing update at the Winter Business Meeting, the brief was expected to be due March 15; however the lender filed its Brief early resulting in an expedited schedule with a deadline of February 22, 2013. The contracted legal firm that was engaged for this assignment agreed to a budget and a fee cap. BOMA Metro Detroit needs the assistance of the IDF to help meet this obligation. It is anticipated that irrespective of the outcome of this appeal, the losing party will appeal further to the Michigan Supreme Court. The decision of the Michigan Court of Appeals is expected in 3-6 months. The Michigan Supreme Court reserved the ability to examine the merits of the Court of Appeals December 27, 2011 opinion should it be the case that the retroactive application of the Nonrecourse Mortgage Loan Act is unconstitutional. Thus, excess funds from this Amicus Brief would be allocated to a subsequent brief or not accessed at all if unnecessary.

VIII. OUTLOOK:

A. Please indicate the likelihood of success of the planned action and your reasons for making such an assessment.

POOR___ FAIR__ GOOD X EXCELLENT___

We have been advised by the Appellant's counsel that the retroactive application of the Nonrecourse Mortgage Loan Act has a good chance of being found constitutional. The Legislature narrowly focused on the problem at issue and surgically addressed the specific "unfair and deceptive business practice" involving the triggering of full recourse liability based on a borrower's post-closing insolvency under nonrecourse loans. MCLA 445.1595. Moreover, the Legislature did not prohibit a loan from being fully recourse based on a post-closing solvency "if the loan documents for that loan do not contain nonrecourse loan provisions." MCLA 445.1594. There is a clear dispute in this case as to the meaning and effect of the words of the loan documents, with the original Borrower, Lender and Guarantor and the entire commercial real estate and CMBS industry understanding the words one way, while only a third party to the original transaction standing to benefit from its interpretation argues for the meaning adopted by the Court. The Legislature determined that, because it was clearly not the understanding of the Borrower, Guarantor or the Lender at the time of contracting, it would be unfair to essentially have deceived the Borrower. Its approach therefore was surgical.

By narrowly tailoring the Act to thwart the specific economic concern presented by having suddenly converted a post-closing solvency covenant into a full recourse liability trigger under nonrecourse loans, the Legislature acted reasonably to serve the public good of the State. It should not be deemed an impairment of contract rights because even the original lender did not expect to be able to hold the Guarantor liable merely because the defaulting borrower was insolvent. The reason why participation at this level and amicus support is being sought is because the case has been receiving notoriety, the statute affords important protections and came as a result of substantial effort and expense of BOMA and the lender will move forward against other borrowers on similar grounds, trying to capitalize on its success in this case and build a cottage industry proceeding against other guarantors even where properties have been foreclosed upon as long as six (6) years ago if there was a deficiency due after sale at foreclosure.

B. Please indicate the likelihood of success of planned action without IDF funding and your reasons for making such an assessment.

POOR ___ FAIR X GOOD ___ EXCELLENT ___

The chances of success in the absence of BOMA's participation separately or as a part of an industry coalition drop because the crux of the appeal relates to the fact that the lower court's opinion is at variance with industry standards and practices in commercial real estate loans. It is important for the Court to see that the Nonrecourse Mortgage Loan Act was not legislation focused on the parties in the case, but rather was directed at solving a problem affecting an entire industry. Thus, industry participation explaining the significance of the decision and its adverse consequences on commercial real estate, real estate tax revenue and jobs is important to the likelihood of success on appeal.

IX. SELF HELP:

A. Please list actions already undertaken toward achievement of the stated project goal:

BOMA has been working closely with Appellant's counsel to review important background information and has been working with experienced local counsel to be ready in connection with applicable dates and deadlines. Due to an expedited briefing schedule, the Amicus Brief for which funding is being sought was filed. The contracted legal firm that was engaged for this assignment agreed to a budget and a fee cap. BOMA Metro Detroit needs the assistance of the IDF to help meet this obligation.

BOMA worked to obtain passage of the Nonrecourse Mortgage Loan Act and is now actively defending the Act on appeal. BOMA has also been working hard on its own independent fundraising efforts in connection with the cost of lobbying for the law's passage and other amicus briefs.

BOMA International's Government Affairs Team will be kept informed throughout this process.

B. Do you have a Government Relations Committee or similar entity to assist and/or provide oversight in pursuing this issue?

Yes. BOMA Metro Detroit has an active and experienced Government Relations Committee that has been reviewing this issue and has recommended participation. It has attorneys on the committee as well that can help review drafts and help reduce legal expenses of outside counsel. We will report regularly to BOMA International's Advocacy staff and the IDF on progress.

X. WORK PRODUCT:

A. Will this application result in a work product that may be used by other BOMA members, local associations, or state coalitions?

YES X NO ___

The realistic concern is that, unless the Nonrecourse Mortgage Loan Act is sustained in this appeal or the underlying case in the Michigan Court of Appeals or reversed on appeal to the Michigan Supreme Court, this issue would spread to other states. BOMA's participation at this stage is an investment to prevent that. In any case, the amicus brief and the research and advocacy would be available in case other lenders get similar ideas. The amicus could be converted to a resource guide for members and the legislative process will be documented as an additional resource.