

## COA Opinion: Actions at law are recognized and permitted for deficiencies on foreclosure by advertisement, regardless of whether the mortgage was extinguished.

29. December 2011, By Kristina Araya

In *Wells Fargo Bank, NA v. Cherryland Mall Ltd. P'ship*, No. 304682, the Michigan Court of Appeals affirmed the trial court's judgment awarding plaintiff money damages on its mortgage deficiency claim and for attorney fees.

This case arises out of a commercial mortgage-backed securities (CMBS) loan. A CMBS loan has a unique structure: a non-recourse basis in exchange for the isolation of the assets to be financed. Two components of asset isolation are separateness covenants and limited recourse provisions limiting the lender's general agreement not to pursue recourse liability. Accordingly, in a CMBS financing, in the event on "recourse triggers" on the part of the borrower, the lender's agreement not to pursue recourse liability against the borrower or owner has limited application, allowing the lender to pursue recourse as part of its remedies.

In this case, defendant partnership obtained a CMBS loan from plaintiff, using property it owned as collateral. When defendant partnership failed to make a mortgage payment, plaintiff commenced foreclosure by advertisement and a sheriff's sale was conducted, leaving a deficiency of approximately \$2.1 million on the loan. Plaintiff then filed suit to enforce the loan documents for the deficiency against mortgagor and the guarantor of the loan. Plaintiff filed multiple summary disposition motions, of which all but one were granted in favor of plaintiff. Defendants appealed two motion grant rulings. The first objection by defendants was to the grant of summary disposition for plaintiff on the finding that the guarantor was liable for the entire loan deficiency because the trial court had concluded that insolvency was a violation of defendant's requirement that it remain its

single purpose entity (SPE) status. The second objection was as to the award of attorney fees to plaintiff.

Defendants first argued that the mortgage, and its terms and conditions, were extinguished upon foreclosure, thereby barring the suit because the deficiency suit was initiated following the foreclosure sale. While this is the general rule in Michigan, the trial court found that the terms and conditions were not extinguished by the foreclosure because of an indemnification for losses provision in the mortgage, and such provision survived any foreclosure sale. Nevertheless, the Court of Appeals did not address whether the mortgage was extinguished because it found that actions at law are recognized and permitted for deficiencies on foreclosure by advertisement, regardless of whether the mortgage was extinguished. The basis for such deficiency lawsuits is not based on the mortgage, but instead on the note. Thus, the Court of Appeals concluded that the terms of the note entitle plaintiff to maintain a suit for a collection of deficiency.

Defendants then argued that it was error to find that defendants were liable under the note based on a violation of the SPE requirements. Defendants argued that its insolvency was not a violation of the SPE status, and that the mortgage was ambiguous and the extrinsic evidence presented by defendants showed that solvency was not required to maintain SPE status. The note, mortgage and guaranty all provide that the loan debt becomes fully recourse if defendant fails to maintain SPE status. Thus, there is no dispute that defendants must maintain SPE status, but the parties essentially disagree as to what defendants must do to maintain that status. Plaintiff argues that the mortgage, expressly incorporated by the note, requires defendants to remain solvent and the insolvency triggered full recourse against the borrower and guarantor. Defendants contend that the mortgage does not require solvency to maintain SPE status. The Court of Appeals approached this issue through a question of contract interpretation, and found that although the mortgage did not specifically define SPE status, the trial court erred when it failed to define a “single purpose entity” and by failing to consider extrinsic evidence to the extent necessary to help define and explain the

meaning of the phrase. The Court of Appeals turned to extrinsic evidence from the industry to define “single purpose entity”, but found that this was not informative as to how the parties defined it. The Court then turned to the actual mortgage to decide that all the terms under the “Single Purpose Entity/Separateness” provision were necessary to maintain SPE status. The Court of Appeals found that the heading was persuasive in determining that the mortgage was unambiguous, and that maintaining “separateness” and “single purpose entity” were intertwined concepts because of their placement in the headings. Thus, all the covenants below the heading were required to maintain SPE status. The Court also looked to other cases interpreting similar loan documents, and found that they do not support defendants’ position that the requirements listed under the “Single Purpose Entity/Separateness” provision do not relate to maintaining SPE status.

The Court also found irrelevant defendants’ argument that the insolvency was due to market conditions and not created by the owners, thus presenting no violation. The Court found that any failure to remain insolvent, no matter what the cause, was a violation.

The Court of Appeals agreed with the trial court in finding that the mortgage, as incorporated into the note, unambiguously required defendant to remain solvent in order to maintain its SPE status and having admitted its insolvency, defendant violated the requirements, resulting in the loan becoming fully recourse. The judgment for the deficiency amount and for attorney fees was affirmed.