Reading Assignment: Casebook pages 429-438. Discussion questions to accompany this material:

1. Assume that Uphoff borrowed $300,000 from Landmark Bank (Landmark) to refinance his previous mortgage. He signed a promissory note agreeing to repay $300,000 to Landmark, and he granted Landmark a deed of trust on his home. Three weeks ago, while cooking meth, Uphoff caused an explosion that started a fire and burned his house down. Uphoff’s casualty insurer has refused to cover the damage, claiming that the policy doesn’t cover damages resulting from Uphoff’s criminal behavior.\(^1\) Has Uphoff committed waste? Does Landmark have to bring an action against Uphoff in tort for waste in order to recover anything from Uphoff, or can it just bring an action against Uphoff in contract for the unpaid balance of the note?

2. Why did Prudential (the mortgage lender in the *Spencer’s Kenosha Bowl* case) bring an action against Spencer’s for waste? Why didn’t it just sue them for a judgment on the debt?

3. Suppose that Borrower engages in the following actions or failures to act. Which of them would be waste? To what extent do the terms of the mortgage control? What if the mortgage is silent? What additional information, if any, would you need?

   (a) Borrower failed to pay last year’s assessed real estate taxes on the mortgaged property ($50,000).

   (b) Borrower did not repair or replace the roof on the property when the old one began to leak.

   (c) To reduce its casualty insurance premiums, Borrower modified the terms of its casualty insurance policy to increase the policy deductible from $1,000 to $500,000.

4. When a commercial loan is a nonrecourse loan, the mortgagee’s ability to pursue a waste claim *against the mortgagor* is useless if the mortgagor is a “single-asset real estate” entity—there are no other assets against which the mortgagee could collect a judgment. With these loans, the mortgagee often requires a “guarantee” agreement from certain key individuals associated with the mortgagor.

   The agreement that follows is a typical form used in some commercial mortgage loan transactions. How is this agreement different from a regular guaranty agreement? What is it that the guarantor is actually guaranteeing? What happens if the mortgagor collects rents but does not turn them over

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\(^1\) As we’ll see in the next assignment, this shouldn’t actually hurt Landmark. If Landmark does its due diligence, it will make sure that the insurance policy has a “standard mortgage” clause in it, which is a clause under which the insurer agrees that even if it has a valid defense to payment against the mortgagor, the insurer will not assert that defense against Landmark and will still reimburse Landmark for its loss due to the destruction of the collateral.

For the sake of this problem, assume that Landmark failed in its due diligence such that the policy did not contain such a clause, and thus Landmark cannot assert a valid claim against Uphoff’s insurer.
to the mortgagee? What happens if the mortgagor defaults and the mortgagee conducts a foreclosure sale, but the sale does not bring enough to satisfy the debt because market values have dropped?

GUARANTY OF NONRECEIVE CARVEOUT OBLIGATIONS

THIS GUARANTY OF NONRECOURSE CARVEOUT OBLIGATIONS (hereinafter referred to as this “Guaranty”) dated as of [date], by [name], a ___________________ corporation (hereinafter referred to as “Guarantor”) in favor of [lender] (hereinafter referred to as “Lender”).

WITNESSETH:

WHEREAS, [name] (hereinafter referred to as “Borrower”) has borrowed from Lender a sum of money in the original amount of $____________ (hereinafter referred to as the “Loan”), as evidenced by that certain Promissary Note in the amount of $____________, of even date herewith made by Borrower in favor of Lender (hereinafter referred to as the “Note”) and secured by that certain Mortgage and Security Agreement (hereinafter referred to as the “Mortgage”) of even date herewith executed by Borrower in favor of Lender encumbering the land (hereinafter referred to as the “Land”) lying and being in [county], [state], and more particularly described in Exhibit A attached to the Mortgage, and all of the improvements located on the Land (hereinafter referred to as the “Improvements;” the Land and the Improvements hereinafter referred to collectively as the “Security”). The Note, the Mortgage, and any other documents and instruments now or hereafter evidencing, securing, or relating to the Loan, as more particularly defined and described in the Mortgage, are referred to herein as the “Loan Documents”;

WHEREAS, to induce Lender to make the Loan, Guarantor has agreed to guarantee the Guaranteed Obligations (as defined below) as hereinafter set forth;

WHEREAS, Guarantor acknowledges receipt of copies of the Mortgage, the Note and the other Loan Documents, and has reviewed such documents;

WHEREAS, it is to the benefit of Guarantor that Lender extends the Loan to Borrower; and

WHEREAS, Guarantor now desires to execute and deliver this Guaranty;

NOW THEREFORE, in consideration, the receipt and sufficiency of which are hereby acknowledged, Guarantor agrees as follows:

1. Guarantor hereby unconditionally, irrevocably, and absolutely guarantees all liabilities, claims, losses, deficiencies, judgments, damages, costs, and expenses of every kind and nature (including, without limitation, reasonable attorneys’ fees and disbursements and court costs) arising out of or in connection with any of the following, to the extent set forth below (hereinafter referred to collectively as the “Guaranteed Obligations”):

   a. any fraud or breach of trust by Borrower or any Guarantor or direct or indirect member, shareholder, partner, principal, affiliate (including Property Manager if Property
Manager is an affiliate), employee, officer, director, agent, or representative of Borrower or Guarantor (each, a “Related Party”), including by reason of any claim under the Racketeer Influenced and Corrupt Organizations Act (“RICO”);

b. the misapplication of any insurance proceeds or condemnation awards;

c. the failure of Borrower or any Related Party to direct or pay rents or proceeds received by Borrower or any Related Party to the proper account as required under the Loan Documents;

d. the misapplication by Borrower or any Related Party (or at any such Person’s direction) of monies held in or paid out from any account (including any reserve or escrow) maintained under any of the Loan Documents;

e. any and all tenant security deposits held by or on behalf of Borrower not being properly applied, returned to tenants when due or delivered to Lender, any receiver or any Person purchasing the Security at a foreclosure sale upon the taking of possession of the Security by Lender, such receiver or other Person as provided herein;

f. wrongful removal or destruction of property constituting the Security or any waste of the Security by Borrower or a Related Party which reduces the value of the Security;

g. any Legal Requirement (including RICO) mandating the forfeiture by Borrower of the Security, or any portion thereof, because of the conduct or purported conduct of criminal activity by Borrower or any Related Party in connection therewith;

h. any misrepresentation, miscertification, or breach of warranty by Borrower with respect to any representation, warranty, or certification contained in this Agreement or any other Loan Document or in any document executed in connection therewith, pursuant to any of the Loan Documents or otherwise to induce Lender to make the Loan, or any advance thereof, or to release monies from any account held by Lender (including any reserve or escrow) or to take any other action with respect to any of the collateral securing the Loan;

i. any damage or destruction of the Security or any part thereof due to fire or other casualty to the extent not covered by insurance required under the Mortgage;

j. the failure to pay charges for labor or materials or taxes or other charges that can create liens on any portion of the Security;

k. a breach by Borrower of any of the covenants contained in Sections ___ [Transfers], ___ [Liens], ___ [Indebtedness], or [ERISA] of the Loan Agreement;

l. a breach of any of the provisions of Section ___ [Single Purpose Entity/Separateness] of the Loan Agreement;
The obligations of Guarantor hereunder are continuing, absolute, and unconditional, irrespective of any circumstance whatsoever which might otherwise constitute a legal or equitable discharge or defense of Guarantor. Without limiting the generality of the foregoing, the obligations of Guarantor hereunder shall remain in full force and effect without regard to, and shall not be released, discharged or in any way affected by:

a. any amendment, modification, or supplement to the Mortgage, the Note, or any other Loan Document;

b. any exercise or nonexercise of or delay in exercising any right, remedy, power, or privilege under or in respect of this Guaranty, the Mortgage, the Note, or any other Loan Document (even if any such right, remedy, power, or privilege shall be lost thereby), or any waiver, consent, indulgence, or other action or inaction in respect thereof;

c. any failure to perfect or continue perfection of, or any release, discharge, or waiver of, any rights given to Lender in any property as security for the performance of any of the Guaranteed Obligations, or any additional security taken for the Loan, whether real or personal property;

d. any extension of time for payment or performance of any of the Guaranteed Obligations;

e. the genuineness, validity, or enforceability of the Loan Documents;
f. any limitation of liability of Borrower or its partners contained in any Loan Document;

g. any defense that may arise by reason of the failure of Lender to file or enforce a claim against the estate of Borrower in any bankruptcy or other proceeding;

h. any voluntary or involuntary liquidation, dissolution, sale of all or substantially all of the property of Borrower, or any marshalling of assets and liabilities, or other similar proceeding, affecting Borrower or any of its assets;

i. the release of Borrower or Guarantor from performance or observance of any of the agreements, covenants, terms, or conditions contained in the Loan Documents by operation of law or otherwise;

j. the failure of Lender to keep Guarantor advised of Borrower’s financial condition, regardless of the existence of any duty to do so;

k. any sale or other transfer of the Security or any part thereof or any foreclosure by Lender on the Security or any part thereof; or

l. any other circumstances which might otherwise constitute a legal or equitable discharge of a guarantor or surety.

No set-off, claim, reduction, or diminution of any obligation, or any defense of any kind or nature which Borrower or Guarantor now has or hereafter may have against Lender shall be available hereunder to Guarantor against Lender. Guarantor’s liability under this Guaranty shall continue until all Guaranteed Obligations to Lender have been satisfied, and shall not have been reduced by virtue of any payment by Borrower of any amount due under the Note or under any of the Loan Documents or by Lender’s recourse to any collateral or security.

3. Severability. This Guaranty is a guaranty of payment and performance and not of collection, and is not conditioned or contingent upon the genuineness, validity, or enforceability of the Loan Documents or other instruments relating to the creation or performance of the Guaranteed Obligations or the pursuit by Lender of any remedies which it now has or may hereafter have with respect thereto under the Loan Documents, at law, in equity, or otherwise. Lender may pursue its rights and remedies under this Guaranty and under the other Loan Documents in whatever order, or collectively, and shall be entitled to payment and performance hereunder notwithstanding such other Loan Documents and notwithstanding any action taken by Lender or inaction by Lender to enforce any of its rights or remedies against any other guarantor or any other Person or property whatsoever.

[Signature block]