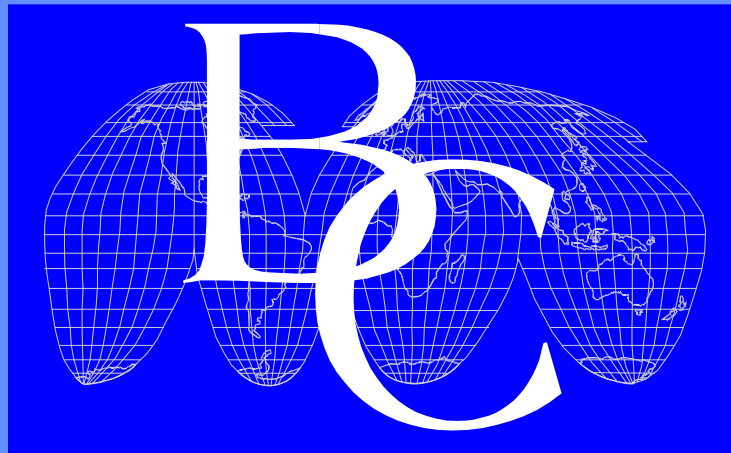


STRATEGIC RECOURSE ISSUES “REG B” OVERVIEW

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OVERVIEW OF KEY RECOURSE ISSUES

- ◆ **RECOURSE -- STATUTORY, CONTRACTUAL AND PRACTICAL CONCERNS**
 - STATUTORY LIMITATIONS ON RECOURSE UNDER STATE LAW
 - DE FACTO LIMITATIONS ON RECOURSE RESULTING FROM THE STRUCTURE OF THE DEAL AND/OR THE PARTIES
 - CONTRACTUAL LIMITATIONS ON RECOURSE
- ◆ **RECOURSE AGAINST THIRD PARTIES – I.E., GUARANTORS, INVESTORS, TITLE COMPANIES AND OTHERS**
- ◆ **ALTERNATIVES TO RECOURSE ONLY AGAINST THE PROPERTY AND THE BORROWER**

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STATUTORY RECOURSE LIMITATIONS

- ◆ **ANTI-DEFICIENCY RULES (APPLICABLE TO DOTs AND MORTGAGES)**
 - RESTRICTS RECOURSE TO THE COLLATERAL
 - PROTECTIONS FOR BORROWERS USUALLY EXTENDED TO GUARANTORS
- ◆ **ONE-ACTION RULES (CA, NV, WA, UT)**
 - ESTABLISHES METHOD OF PURSUING RECOURSE WHEN A DEBT IS SECURED BY REAL PROPERTY
 - MAY OBTAIN WAIVERS TO PURSUE OTHER REMEDIES OR OTHER COLLATERAL
 - EXCEPTIONS – ENVIRONMENTALLY IMPAIRED PROPERTY, LETTERS OF CREDIT AND OTHER COLLATERAL

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PRACTICAL RECOURSE LIMITATIONS

◆ DE FACTO RECOURSE LIMITATIONS

- SINGLE ASSET BORROWER
- THIRD PARTY PLEDGOR OF REAL PROPERTY COLLATERAL
- DAMAGE, DESTRUCTION AND CONDEMNATION – APPLICATION OF PROCEEDS

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REACHING BEYOND THE LIABILITY SHIELD

◆ INTER-COMPANY DEBT ISSUES

- WHY SUBORDINATION AGREEMENTS ARE IMPORTANT
- PRIORITY IN A BANKRUPTCY PROCEEDING

◆ CLAW-BACK OF OWNER DISTRIBUTIONS:

- ROLE OF INSOLVENCY DUE TO DISTRIBUTIONS
- IMPROPER DISSOLUTION UNDER ORGANIZATIONAL DOCUMENTS
- MUST PAY ALL CREDITORS AS PART OF OR PRIOR TO ORDERLY DISSOLUTION

◆ BANKRUPTCY CONCEPTS

- PREFERENTIAL TRANSFER RULES
 - ☞ INSIDER VS. OUTSIDER DEBT RULES

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CONTRACTUAL RECOURSE LIMITATIONS

◆ CONSTRUCTION LOANS

- COMPLETION GUARANTY VS. PAYMENT GUARANTY
- RARELY INCLUDE RECOURSE LIMITATIONS, OTHER THAN DE FACTO LIMITS WITH AN SPE BORROWER

◆ LOANS WITH LIMITED RECOURSE PROVISIONS

- STANDARD “BAD-BOY CARVE-OUTS”
- SPRINGING RECOURSE
- RECOURSE BURN-OFFS OR STEP-DOWNS
- RECOURSE ALLOCATION AMONG SEVERAL GUARANTORS (I.E., SEVERAL LIABILITY)

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LENDER RECOURSE ALTERNATIVES

◆ FUNDING OR EQUITY AGREEMENTS

- USED WITH EQUITY INVESTORS AND SIMILAR PARTIES
- DIRECT OBLIGATION VS. SURETY OBLIGATIONS
- USED WITH OR WITHOUT A SEPARATE NOTE

◆ THIRD PARTY ACCOMMODATOR

- USUALLY SUBJECT TO RECOURSE LIMITATIONS
- GUARANTOR WAIVERS
- CONSIDERATION IS ALWAYS AN ISSUE

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TRUSTS

◆ REVOCABLE TRUSTS

- CAN BE MODIFIED, TERMINATED OR TRANSFER ASSETS INTO OR OUT OF TRUST
- ALTER EGO WITH SETTLOR/TRUSTEE
 - ☛ CAN HAVE 3RD PARTY TRUSTEE TO ADDRESS ALTER EGO ISSUES
- EASE OF TRANSFER OR TERMINATION DOES NOT PROVIDE SAFEGUARDS AGAINST FRAUDULENT CONVEYANCE
 - ☛ BUT, POSES SERIOUS PRACTICAL RISKS OF RECOVERY

◆ IRREVOCABLE TRUSTS

- FINITE TERM AND EXPRESS LIMITATIONS ON TRUSTEE POWERS
- ASSETS CANNOT BE ADDED OR WITHDRAWN
- TRUSTEE IS NEVER ALTER EGO

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TRUSTS (PART TWO)

◆ REVOCABLE VS. IRREVOCABLE TRUSTS

- REVOCABLE TRUST = INCLUDE SETTLOR/TRUSTEE AS CO-OBLIGOR WITH SAME STATUS AS TRUST
 - ☞ NOT APPROPRIATE FOR TRUSTEE FOR IRREVOCABLE TRUST
- IRREVOCABLE TRUST = NEEDS TO EXPRESSLY BE PERMITTED TO PLEDGE ASSETS, GUARANTY OBLIGATIONS, ETC.
- REVOCABLE TRUST SHOULD STAY IN PLACE UNTIL DEBT PAID, WHILE IRREVOCABLE TRUST MUST BE FOR A TERM LONGER THAN LOAN TERM
 - ☞ CAN PROVIDE FOR REPLACEMENT OBLIGOR BASED ON BENEFICIARIES OF THE TRUST
- REVOCABLE TRUST SHOULD HAVE CONTRACTUAL LIMITATIONS ON TRANSFERS (I.E., NEGATIVE PLEDGE) OR FINANCIAL COVENANTS
 - ☞ SUCH PROTECTIONS NOT NECESSARY FOR IRREVOCABLE TRUST BECAUSE OF TRUST LIMITATIONS

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REG B ISSUES

- ◆ YES, IT APPLIES TO COMMERCIAL LOANS!
 - LANGUAGE REFERS TO ALL LOANS, NOT JUST CONSUMER LOANS
 - SLIGHTLY DIFFERENT RULES APPLY TO BUSINESSES WITH REVENUES ABOVE OR BELOW \$1MM ANNUALLY
- ◆ MAIN AREAS OF INTEREST/CONCERNS
 - PROPER NOTICES
 - JOINT APPLICATIONS
 - INVOLVEMENT OF SPOUSES

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REG B ISSUES – PROPER NOTICES

◆ KEY NOTICES UNDER REG B

- A CREDITOR SHALL NOTIFY AN APPLICANT OF ACTION TAKEN WITHIN:
 - ☞ (I) 30 DAYS AFTER RECEIVING A COMPLETED APPLICATION CONCERNING THE CREDITOR'S APPROVAL OF, COUNTEROFFER TO, OR ADVERSE ACTION ON THE APPLICATION;
 - ☞ (II) 30 DAYS AFTER TAKING ADVERSE ACTION ON AN INCOMPLETE APPLICATION, UNLESS NOTICE IS PROVIDED IN ACCORDANCE WITH PARAGRAPH (C) OF THIS SECTION;
 - ☞ (III) 30 DAYS AFTER TAKING ADVERSE ACTION ON AN EXISTING ACCOUNT; OR
 - ☞ (IV) 90 DAYS AFTER NOTIFYING THE APPLICANT OF A COUNTEROFFER IF THE APPLICANT DOES NOT EXPRESSLY ACCEPT OR USE THE CREDIT OFFERED.

◆ HARDEST QUESTION – WHEN DO YOU SEND THE NOTICES?

- EVERYTHING IS TIED TO USING A FORMAL LOAN APPLICATION

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REG B ISSUES – JOINT APPLICATIONS

◆ SPOUSES

- ONE SPOUSE SIGNING, EVEN IN A COMMUNITY PROPERTY STATE, DOES NOT IMPLY A JOINT APPLICATION FOR CREDIT
 - ☞ MUST IDENTIFY ALL CO-APPLICANTS AND HAVE THEM SIGN THE APPLICATION

◆ OTHER JOINT APPLICANTS

- SAME PRINCIPALS APPLY TO:
 - ☞ JV PARTNERS,
 - ☞ GENERAL PARTNERS,
 - ☞ TIC OWNERS, AND
 - ☞ CO-GUARANTOR PARTIES

◆ MAKE SURE ALL PARTIES SEEKING CREDIT EXECUTE THE APPLICATION

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REG B ISSUES – JOINT APPLICATIONS (PART 2)

- ◆ MULTIPLE APPLICATIONS SHOULD IDENTIFY CO-APPLICANTS CLEARLY AS SUCH:
 - REGULATION B *SPECIFICALLY PROHIBITS* A CREDITOR FROM TREATING THE SUBMISSION OF A JOINT FINANCIAL STATEMENT OR OTHER EVIDENCE OF JOINTLY HELD ASSETS AS AN APPLICATION FOR JOINT CREDIT.
 - ☞ CANNOT REQUIRE A SPOUSE TO SIGN UNLESS THEY CLEARLY REQUEST TO BE A JOINT APPLICANT
 - THERE HAS TO BE A SEPARATE AND SPECIFIC EVIDENCE OF THE INTENT OF THE PARTIES TO APPLY JOINT FOR THE CREDIT.

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REG B ISSUES – FEDERAL LAW VS. STATE LAW

◆ FEDERAL LAW SUPERSEDES STATE LAW

- ONLY APPLIES WHEN STATE LAW CONFLICTS OR COVERS SAME ISSUES AS STATE LAW
- ADDITIONAL STATE LAWS MUST BE FOLLOWED
- MORE PROTECTIVE STATE LAWS MUST BE FOLLOWED

◆ RECORDS RETENTION

- 12 MONTHS FOR COMMERCIAL LOANS VS. 25 MONTHS FOR BUSINESS LOANS

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REG B ISSUES – INTERPLAY WITH DODD-FRANK

- ◆ The Dodd-Frank Act increases the compliance stakes in the commercial application process through new data collection requirements.
 - Section 1071 of the Dodd-Frank Act amended the ECOA to require lenders to collect additional data at the time an application is submitted when the applicant is a small business, or a minority-owned or women-owned business. This change is often referred to as the new “small business data collection” requirements, and the 14 data points specified in Section 1071 are similar, but not identical, to data collected for HMDA and CRA reporting.
 - This data must be maintained and ultimately reported to the CFPB annually and others upon request.

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REG B ISSUES – INTERPLAY WITH DODD-FRANK (PART 2)

- ◆ A few key questions that you should ask:
 - What constitutes a credit application according to your institution’s policies?
 - ☞ How do your practices differ, if at all?
 - When is a credit application ‘complete’ according to your institution’s policies and practices?
 - ☞ Use of standardized forms make it most clear.
 - ☞ Focus on written evidence of compliance.

REAL ESTATE AND
COMMERCIAL LOAN
DOCUMENTATION
SERVICES

