Indemnity Equals Guaranty

COUNSEL'S CORNER

Michael Smuck and Edwin White wanted to purchase an apartment complex known as "The Falls," located generally in the southeast quadrant of I-30 and Loop 820 in Fort Worth. They formed a special purpose entity (SPE) called MBS-The Falls, Ltd. for that purpose, and yet another SPE to serve as the general partner of MBS-The Falls.

To acquire the apartments, MBS-The Falls signed a $9 million note, deed of trust, security agreement and other loan docs pledging the real estate. Wells Fargo Bank became the owner of the loan docs through an assignment.

The loan provided for non-recourse financing. As such, the liability of MBS-The Falls was limited to its equity in the apartment complex, unless a non-recourse exception was triggered. The non-recourse exceptions that could impose liability upon MBS-The Falls were listed in the Note.

MBS-The Falls defaulted on the Note, and Wells Fargo foreclosed. Wells Fargo filed suit in Tarrant County alleging waste and that the owner allowed liens to be filed against the property, which impaired the value of Wells' collateral.

At trial in Tarrant County, Wells Fargo obtained a judgment against MBS-The Falls for $10+ million. With that judgment in hand, Wells Fargo then sued Messrs. Smuck and White in Harris County for that amount. Wells Fargo claimed that Smuck and White were 100% liable for the judgment obtained in Tarrant County against the owner of the apartments.

The basis for Wells' Harris County lawsuit is contained in a document signed personally by Smuck and White captioned "Non-Recourse Indemnification Agreement." In that agreement both Smuck and White agreed to indemnify the lender for all losses incurred.

Smuck argued that he would be liable to Wells Fargo only if a third-party asserted a claim, and not merely if Wells Fargo had incurred losses.

White claimed that the judgment rendered in Tarrant County was not based on the non-recourse exceptions, and further that Wells Fargo failed to establish that any non-recourse exceptions had been triggered.

The Harris County court agreed with Smuck and White. Wells Fargo appealed.

The Harris County Court of Appeals first looked at the Indemnification Agreement. Despite the terminology of "*Indemnity*," the Court had little problem concluding that it was essentially a "*Guaranty*," for which Smuck and White were jointly and severally 100% liable for all losses suffered by Wells Fargo.

And from there it wasn't difficult for the Court of Appeals to toss out all the secondary arguments used by Smuck and White.

The Harris County Court of Appeals reversed the trial court's judgment. Wells Fargo won; Smuck and White lost.

See *Wells Fargo Bank, N.A. v. Smuck and White*; No. 14-12-00574-CV; Texas 14th Court of Appeals, July 9, 2013.

Lessons learned:

1. It's easy to be lazy and not carefully read loan docs, leases and contracts; goodness knows they are as boring as watching a little league baseball game. In August. In Texas. With a 4p start time. The only surprise here is that Smuck and White were able to convince a trial court that the Indemnity Agreement they signed did not impose liability on them for Wells Fargo's substantial losses.

2. Don't assume that non-recourse means no liability can be imposed. There is a new theory being used across the nation right now that even diminishment in value caused by recessionary market conditions can impose personal liability. Most of us don't think that was the real purpose of non-recourse, "bad boy" or "carve out" provisions but at least some Courts do not agree.

3. **Come see me at the NTCAR Commercial Real Estate Expo on August 28 at the Sheraton in downtown Dallas, and tell me how I can approve these articles and what I should write about. I've got a booth!**

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