The "CMBS Form" of Intercreditor Agreement—Time for A Fresh Look?

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Almost 10 years ago, the form of intercreditor agreement that market participants frequently refer to as the "CMBS," "CMSA" or "S&P" form, was introduced in various media.[1]

A group of market participants developed this form. The principal goal of this group was to prepare a standardized form to facilitate the rating of securitized mortgage loans that were originated as part of a financing stack that included both mortgage and mezzanine financing. In so doing, the group aimed to create transactional efficiencies by streamlining the negotiation process, reducing transaction costs and simplifying the process of rating transactions that included mezzanine financing. Before the development of this form, intercreditor agreements were negotiated on a deal-by-deal basis, or among parties based on precedent that they had agreed to among themselves.

Since its introduction, the CMBS form has attained broad acceptance within the market, and rating agencies such as Standard and Poors Corporation, among other rating agencies, have issued pronouncements as to the acceptability of the form.[2] The form and various negotiated variants of it have been utilized in connection with many transactions, involving billions of dollars of real estate financing.[3]

Because of the pervasive market acceptance of the form, the transactions in which this form or variants of it have been used have included not only transactions in which the financing stack consists of a mortgage loan intended for securitization and a mezzanine loan, but also transactions involving multiple tranches of mezzanine debt, and transactions in which the mortgage loan was not intended for securitization but rather for syndication or to be held in the portfolio of the originating lender. Moreover, although the original form was developed for a securitization product, for use in connection with financing transactions that involve stabilized, income-producing commercial real estate assets, the form has come to be used in connection with many transactions that fall outside this template, including transactions involving construction financing and for-sale condominium projects.

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[1] *See* Forti and Stafford, "Mezzanine Debt: Suggested Standard Form of Intercreditor Agreement," CMBS World, Spring 2002. References in this article to the "CMBS Form" refer to the version of the Intercreditor Agreement that is available on the website of the CRE Finance Council. Capitalized terms used but not defined in this article have the meaning set forth in the CMBS form.

[2] U.S. CMBS Legal and Structured Finance Criteria, Standard & Poors (May 1, 2003).

[3] For commentary on the CMBS form, *see* Lance, "Structural Protections in Inter-Creditor Agreements for Mezzanine Loans," Briefings in Real Estate Finance, July 1, 2004. ("There is a remarkable degree of consensus today regarding the terms of inter-creditor agreements for mezzanine loans . . . It is hard to think of another finance document which is so widely accepted as an industry standard, or at least as an industry standard template for negotiations.") See also discussion at Berman, "Risks and Realities of Mezzanine Loans," 72 Mo. L. Rev. 993 (2007).

With the benefit of almost 10 years of experience with this form, and in particular in light of the experience of market participants with this form during the current economic and real estate downturn, the time seems right for a fresh look at this form. This article will examine selected aspects of the CMBS form of intercreditor agreement, particularly from the standpoint of the adequacy of the form from the senior lender's perspective.[4] This article will also identify certain shortcomings and blind spots in the form that might deserve reconsideration in connection with the negotiation of intercreditor agreements for future transactions.

Identity of the Mezzanine Lender

The identity and sponsorship of the mezzanine lender is a threshold issue for any senior lender to consider when evaluating a financing transaction in which mezzanine financing will also be provided.

The CMBS form recognizes the significance of this point through its concept of a "Qualified Transferee." Unless a Ratings Confirmation is obtained (or, in the absence of a securitization, the consent of the senior lender), the mezzanine lender may not transfer a controlling position in the mezzanine loan except to a Qualified Transferee.[5] A Qualified Transferee generally must satisfy either "Eligibility Requirements" relating to net worth and overall asset size or ratings criteria.[6]

An anomaly of the CMBS form, however, is that an entity that is controlled by another Qualified Transferee, including the original Mezzanine Lender, is considered to be a Qualified Transferee even if the controlled entity itself does not independently comply with the Eligibility Requirements.[7] This provision, in practice, has facilitated the holding of mezzanine loan positions by single purpose entities, the sole assets of which are their ownership of the single mezzanine loan that is involved in the overall financing. Although that single purpose entity benefits from being treated as a Qualified Transferee because of its sponsorship by another Qualified Transferee that satisfies the Eligibility Requirements, the sponsoring Qualified Transferee that satisfies the Eligibility Requirements is not required to provide a guaranty or otherwise to be on the hook for the single purpose entity's obligations under the intercreditor agreement.

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[4] This article does not consider the tax consequences of certain of the suggestions that are contained herein. Senior mortgagees that are real estate mortgage conduits may be subject to limitations arising under the Internal Revenue Code that may impact the implementation of certain suggestions contained herein. The suggestions herein have also not been vetted with any rating agency with respect to the rating consequences that might flow from the implementation of these suggestions. Finally, nothing in this article is intended to preclude the assertion of any contrary positions by this author in connection with any particular transaction.

[5] CMBS form Section 4(a).

[6] CMBS form Section 4(a) and definitions of "Eligibility Requirements." While mezzanine lenders will fight strongly to limit the suitability criteria for subsequent holders to objective standards like the net worth and asset size tests that are provided for in the Eligibility Requirements in order to maximize the liquidity of the mezzanine lender's position, from the senior lender's standpoint these criteria alone do not capture dimensions of reputation and character that may reflect upon the degree to which the senior lender would want to be doing business with the prospective transferee (or would want to accept the prospective transferee as a replacement sponsor of the mortgage borrower upon a mezzanine foreclosure).

[7] CMBS form, definition of "Qualified Transferee," clause (ii)(D).

One consequence of the respects in which the CMBS form facilitates ownership of mezzanine loans by single purpose entities is that it is not infrequent for the named parties to the intercreditor agreement to be strongly asymmetrical in terms of the assets that stand behind their obligations to perform. In these cases, the senior lender may be a large financial institution or a securitization trust holding substantial mortgage assets, while the mezzanine lender may have the mezzanine loan as its sole asset. In a downturn such as the current one, the assets against which the senior lender could pursue a claim against the mezzanine lender may be limited to the mezzanine lender's impaired mezzanine loan position, while the assets against which the mezzanine lender could pursue a claim against the senior lender may be substantial. In cases where the value of the mezzanine loan is worth little or worthless, the single purpose holder of the mezzanine loan may be emboldened to pursue "nothing to lose"-type strategies that are intended to maximize the hold-up value of its position.

A further consequence of the respects in which the CMBS form facilitates ownership of mezzanine loans by single purpose entities is that the mezzanine lender may have incentives to pursue bankruptcy-related strategies with respect to itself in order to maximize its position. It is curious, given the origins of the CMBS form in the securitization world and its focus on anti-bankruptcy techniques such as single purpose entity borrowers, independent directors that must approve a bankruptcy filing, and non-consolidation opinions, that the CMBS form does not contain restrictions on or other provisions to discourage a single purpose mezzanine lender from utilizing bankruptcy proceedings with respect to itself to adversely impact the senior loan or the exercise of the senior lender's remedies.

One means by which senior lenders might attempt to mitigate this feature of the CMBS form would be to require the obligations under the intercreditor agreement of the controlled entity that does not independently comply with the Eligibility Requirements to be guaranteed by its controlling entity that does comply with the Eligibility Requirements.

Standstill Obligations of the Senior Lender

The CMBS form provides for standstill obligations of the senior lender following a default on the senior loan. Rather than referring to these obligations as "standstill" obligations, however, the CMBS form casts these obligations in the seemingly more benign form of "cure rights" of the mezzanine lender, whereby the senior lender may not "commence" any "Enforcement Action"[8] as a result of an Event of Default under the senior loan unless a cure period available to the mezzanine lender has expired without the mezzanine lender having effectuated a cure.[9] (The situation where an Event of Default exists under the senior loan, and has not been cured by the mezzanine lender within the applicable cure period, is defined in the CMBS form as a "Continuing Senior Loan Event of Default.")

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[8]CMBS form, Section 11(a).

[9] As an interesting point of contrast, the model form of intercreditor agreement promulgated by the ABA Committee on Commercial Finance for lenders holding first lien and second lien positions in the same collateral imposes a standstill obligation upon the second lien lender if a default exists under the first lien loan. The first lien lender has the exclusive right in that case to foreclose. The second lien holder may protect its position by exercising an option to purchase the first lien loan. *See* Report of the Model First Lien/Second Lien Intercreditor Agreement Task Force, ABA Committee on Commercial Finance, 65 Bus. Law. 809 (2010).

The definition of "Enforcement Action" in the CMBS form is extremely broad:

> "Enforcement Action" means any (i) judicial or non-judicial foreclosure proceeding, the exercise of any power of sale, the taking of a deed or assignment in lieu of foreclosure, the obtaining of a receiver or the taking of any other enforcement action against the Premises or Borrower, including, without limitation, the taking of possession or control of the Premises, (ii) acceleration of, or demand or action taken in order to collect, all or any indebtedness secured by the Premises (other than giving of notices of default and statements of overdue amounts) or (iii) exercise of any right or remedy available to Senior Lender under the Senior Loan Documents, at law, in equity or otherwise with respect to Borrower and/or the Premises.

As a result of the restrictions on commencement of any Enforcement Action, the senior lender must standstill while its loan is in default, and may not accelerate its loan, make demand for payment, seek a receiver, commence a foreclosure action, or record the notices necessary to commence a power-of-sale foreclosure[10], unless the cure opportunity provided to the mezzanine lender is exhausted.

Moreover, based on the "Enforcement Action" definition, the senior lender may not exercise "any right or remedy available to the Senior Lender under the Senior Loan Documents." This sweeping language calls into question whether operative provisions in the senior loan documents themselves, which are triggered automatically by the existence of a default on the part of the senior borrower, are also suspended during the cure period available to the mezzanine lender. Such automatic provisions that would be triggered by a default could include the commencement of default rate interest, the imposition of late charges, the imposition of a more rigorous approval regime (with respect to budgets, leases, application of insurance proceeds and similar matters), or the imposition of a more rigorous cash management system (such as the commencement of obligations to fund reserves for taxes or insurance or the effectiveness of a cash trap).[11]

Senior lenders should give some thought to whether a standstill of the type provided for in the CMBS form is truly in their interests. One could formulate an alternative approach—that would block the actual completion of a foreclosure or transfer in lieu of foreclosure unless the cure opportunity has been provided, and that would provide for the reinstatement of a previously accelerated loan as in good standing if the cure is timely effectuated—that would seem to protect the mezzanine lender's fundamental position, without imposing undue limits on the ability of the senior lender to exercise interim remedies, protect its collateral position and get the clock

[10] The definition noted above includes an exception for "giving notices of default and statements of overdue amounts." In context, this language does not seem to be intended to authorize the recordation of a notice of default and election to sell that commences the process for a non-judicial foreclosure in many deed of trust jurisdictions, but rather seems to involve merely notice to the borrower of the existence of the default.

[11] The CMBS form contains some seemingly inconsistent provisions on the topic of permissible "Enforcement Actions." For example, Section 11 of the CMBS form contains an optional provision that limits the obligation of the mezzanine lender to pay default rate interest as an antecedent to curing a monetary default, yet the definition of "Enforcement Action" may limit the ability of the senior lender to accrue default rate interest altogether while the mezzanine lender's cure period remains available. Similarly, Section 7(a) of the CMBS form appears to authorize the senior lender to make "Protective Advances," yet the making of such Protective Advances may be an "Enforcement Action" that would be prohibited while the mezzanine lender's cure period remains available.

running as against the borrower on the actions that are needed to proceed with foreclosure.[12] Even though the borrower is not a party to or explicit beneficiary of the intercreditor agreement, the borrower obtains significant gratuitous benefits from the standstill provisions in the CMBS form.[13] Consideration should also be given to developing a more comprehensive set of actions that fall outside the prohibitions against "Enforcement Actions," that could include provisions of the senior loan documents that are triggered automatically by the existence of a default on the part of the senior borrower of the type described above.

Mezzanine Lender Cure Rights

The provisions of the CMBS form (Section 11) with respect to the cure rights of the mezzanine lender generally are as follows: The mezzanine lender is provided a relatively short period (5 business days in the CMBS form following notice within which the mezzanine lender is required to cure monetary defaults. The CMBS form imposes a limit of 4 consecutive months upon the exercise of the mezzanine lender's rights to cure monetary defaults, unless the mezzanine lender is pursuing a foreclosure of its equity collateral and other collateral. (Some negotiated forms impose absolute limits on the number of times the mezzanine lender may cure without foreclosing.) The CMBS form also gives the mezzanine lender rights to cure non-monetary defaults. Initially, the mezzanine lender has the same time period as the borrower to cure. The mezzanine lender is given an extended right to cure of 30 additional days, plus such additional time as may reasonably be needed to cure, in the case of a default which takes longer than 30 days to cure. The CMBS form imposes no outside limit on this extended cure period. In order for this cure period to remain available, however, the mezzanine lender must be causing timely payments of principal and interest to be made on the senior loan. The extended cure rights are cut off if there is a bankruptcy or similar insolvency event of the senior borrower. A further condition to the continuation of the extended cure rights is that there is "no material impairment to the value, use or operation of the Premises."

The CMBS form assumes that the mezzanine lender will have a practical ability to effectuate the cure of non-monetary defaults by the borrower. In some cases, however, it may be impracticable for the mezzanine lender to cure a non-monetary default without completing its own foreclosure sale, a process that, under the applicable circumstances of the transaction, may take months to complete.[14] During this period, the CMBS form requires the senior lender to standstill with

[12] Such a reinstatement provision would work similarly to the reinstatement laws that exist in certain deed of trust jurisdictions, under which the lender may not complete the foreclosure sale unless certain notice periods have passed, and the borrower has the opportunity to reinstate the loan within those notice periods (and cause the de-acceleration of the loan) by paying the unaccelerated amounts that are past due. See e.g. Cal. Civ. Code § 2924c.

[13] "Naturally, any provision that delays the exercise by any mortgage lender of its default remedies can be a boon to the borrower." Lance, "Structural Protections in Inter-Creditor Agreements for Mezzanine Loans," Briefings in Real Est. Fin. (July 1, 2004).

[14] For a discussion of the requirements to be considered in connection with the foreclosure upon pledged equity interests, *see* Temple, "Mezzanine Loan Foreclosure: If It's Necessary Do It Right," N.Y.L.J. (March 12, 2007), and Dopsch and Dunn, "Mezzanine Loan Foreclosure: UCC Sales of Equity Interests under Revised Article 9," 2002 Real Est. Fin. J. 1422. Vornado PS, L.L.C. v. Primestone Inv. Partners, L.P., 821 A. 2d 296 (Del. Ch. 2002), affirmed 822 A. 2d 397 (Del. Supreme Ct. 2003) (applying New York law), includes a description of various steps taken by a mezzanine lender in connection with a mezzanine loan foreclosure that the court held involved a commercially reasonable foreclosure sale under the Uniform Commercial Code of New York.

respect to any Enforcement Action, unless there is a "material impairment to the value, use or operation of the Premises," or unless the senior borrower is in bankruptcy.

As a practical matter, the senior lender should realize that its ability to cut off the cure rights of the mezzanine lender (or, put another way, to cut off the standstill obligations of the senior lender) based on "material impairment" will be limited. Assuming that the mezzanine lender is not prepared to concede that such a "material impairment" exists, the senior lender would have an unenviable choice. On the one hand, it could proceed with its Enforcement Action over the objection of the mezzanine lender, and deal with the potential hold-up ramifications that could arise should the mezzanine lender then seek to challenge the Enforcement Action as unauthorized or chill any subsequent actions by the senior lender that derive from the purported unauthorized Enforcement Action (such as a sale of the mortgaged property following a foreclosure).[15] Alternatively, the senior lender could forbear from proceeding with its Enforcement Action, while it seeks a judicial determination of the existence of a "material impairment." From a timing standpoint, this latter alternative will provide the mezzanine lender with the functional equivalent of an extended time to cure.

Senior lenders should give some consideration to whether further bright lines should be imposed to cut off the mezzanine lender's cure rights (or, again, to cut off the standstill obligations of the senior lender) based on non-monetary defaults such as violation of transfer provisions, violation of limits on further encumbrances, violation of single purpose entity provisions, failure to pay taxes or ground rents or to maintain insurance, misappropriation of funds and proceeds, misrepresentation, fraud, bankruptcy of parties other than the senior borrower, and similar "bad acts." Senior lenders should also seek clear rules that permit them in all cases, without getting tripped up by the limits on "Enforcement Actions," to pay property taxes, pay ground rent, force-place insurance, and make other "Protective Advances." As suggested in Standstill Obligations of the Senior Lender, above, a limitation of the definition of "Enforcement Actions" to the completion of a foreclosure sale would also go a long way to preserving meaningful interim options to the senior lender to address a default by the senior borrower.

Conditions to Foreclosure by the Mezzanine Lender -- Cure of Senior Loan Defaults

Section 5 of the CMBS form provides a series of provisions relating to the ability of the mezzanine lender to foreclose upon or obtain title to its Equity Collateral, unless a Rating Agency Confirmation has been obtained. These provisions include requirements relating to management of the property by a Qualified Manager following the transfer of title to the Equity Collateral, the imposition of a "hard" cash management system, and the delivery of certain notices and opinions. The transferee of the Equity Collateral must be a Qualified Transferee (and, by definition, the original mezzanine lender or any entity controlled by it would qualify as a Qualified Transferee for these purposes).

[15] With respect to this scenario, it is notable that the CMBS form includes a provision that concedes that a violation of the agreement should entitle the non-defaulting party to equitable relief. See CMBS form Section 33. Senior lenders should understand that this provision in its current form clearly cuts both ways and should give some consideration to seeking a clear understanding that the mezzanine lender should not have rights to block a foreclosure by the senior lender and that these provisions are without prejudice to the rights of the senior lender to seek the posting of a bond to protect against the impact of any temporary or preliminary injunctive relief.

Although not identified in the section of the CMBS form that deals with foreclosure (Section 5), and arguably not structured as a true condition to foreclosure, but rather merely a condition to the obligation of the senior lender not to accelerate the senior loan following the transfer of the Equity Collateral, the court in the widely publicized "Stuyvesant Town" case[16] held that provisions that track closely Section 11(b) of the CMBS form required the holder of the mezzanine loan to cure all defaults under the senior loan as a condition to foreclosure. That section provides in pertinent part as follows:

> To the extent that any Qualified Transferee acquires the Equity Collateral in accordance with the provisions and conditions of this Agreement, such Qualified Transferee shall acquire the same subject to the Senior Loan and the terms, conditions and provisions of the Senior Loan Documents for the balance of the term thereof, which shall not be accelerated by Senior Lender solely due to such acquisition and shall remain in full force and effect; provided, however, that… all defaults under the Senior Loan which remain uncured as of the date of such acquisition have been cured by such Qualified Transferee or waived by Senior Lender except for defaults that are not susceptible of being cured by such Qualified Transferee; provided, that such defaults which are not susceptible of being cured do not materially impair the value, use or operation of the Premises.

In the Stuyvesant Town case, the senior loan had already been accelerated, after payment defaults and after the mezzanine lender had elected not to exercise its cure rights and the senior lender had obtained a judgment of foreclosure. After receiving notice of the sale of the mezzanine loan to the defendant and a notice from the defendant of its election to sell its equity collateral at a UCC public sale, the senior lender requested, among other things, confirmation that the mezzanine lender would cure the senior loan default as a condition to the acquisition of the equity collateral. When the mezzanine lender failed to do, the senior lender commenced an action seeking a preliminary injunction. The court granted the preliminary injunction, and held that the "plain language" of the intercreditor agreement obligated the mezzanine lender to cure all senior loan defaults before it could acquire the equity collateral, including the payment of the senior loan as accelerated.

Notwithstanding the holding in the Stuyvesant Town case, senior lenders would be well advised to include the cure of senior loan defaults as an express condition to the completion of the

[16] Bank of America, N.A., as Trustee, et al. v. PSW NYC LLC, 2010 WL 4243437 (N.Y. Sup. Ct. 2010).

mezzanine lender's foreclosure upon, or other exercise of rights of control over[17], the equity collateral.

Conditions to Mezzanine Foreclosure – Delivery of Substitute "Third Party Agreements" and Guarantees

Section 4 of the CMBS form also includes provisions that relate to the impact of a transfer of Equity Collateral upon any pre-existing guaranty, indemnity, pledge agreement or other "Third Party Agreement." In language that is at best obscure, the CMBS form requires the transferee of the Equity Collateral, or an affiliate thereof reasonably satisfactory to the senior lender, to deliver a substitute guaranty, indemnity, pledge agreement or other Third Party Agreement. However, this delivery is only required if the transfer of the Equity Collateral "results in the removal of any guarantor, indemnitor, pledgor or other obligor under the Senior Loan Documents."

The process whereby the foreclosure or other transfer of the Equity Collateral will result in the "removal" of the senior lender's guarantor is not obvious. Is this intended to refer to "removal" of the guarantor as a guarantor, removal of the guarantor as an equity holder or controlling person in the senior borrower, or some other phenomenon? In fact, the well-drafted senior guaranty form would by its terms continue in effect notwithstanding a transfer in the ownership or control of the senior borrower. Even in the case where a well-represented sponsor negotiates to limit its exposure under a carve-out guaranty to "bad acts" that occur prior to the mezzanine foreclosure, however, the "removal" language does not clearly characterize an agreement that the pre-existing guarantor's exposure will cease upon a mezzanine foreclosure with respect to "bad acts" occurring thereafter.[18]

Moreover, it is not clear why the CMBS form dances around this point with such inartful language. Assuming that the senior loan is a non-recourse loan with standard carveouts for "bad acts," and further assuming that the senior borrower is a single purpose entity with no assets other than the collateral for the senior loan, the senior lender's claim with respect to the carveouts would not be supported by an asset base beyond the assets that are already collateral for the loan without an appropriate carveout guarantor agreeing to stand behind the senior

[17] Because the rights of the mezzanine lender under its pledge typically include a proxy or right to exercise the voting power or control of the mezzanine borrower over the mortgage borrower while a mezzanine loan default exists, in theory it would be possible for the mezzanine lender to control the mortgage borrower without having to complete a foreclosure sale. Accordingly, in addition to structuring conditions to foreclosure by the mezzanine lender, the senior lender should consider structuring relevant conditions for the mezzanine lender's exercise of control over the mortgage borrower through the exercise of its proxy rights, potentially including requirements for the delivery of a carveout guaranty or other recourse-creating instrument to preclude the use of the proxy rights in a fashion that could result in a bankruptcy filing or other "bad act." It may be possible to achieve a similar outcome by requiring the proxy rights of the mezzanine lender to be confined so as to exclude a bankruptcy filing or other "bad acts" from the actions that the mezzanine lender may exercise its proxy rights to accomplish.

[18] For additional commentary on these provisions of the CMBS form, *see* Gewurz, Ippolito and Levy, "Nonrecourse Carveout Guaranties and Mezzanine Loans," Real Est. Fin. and Inv. (November 8, 2010). ("The CMSA form intercreditor does not require mezzanine lenders to deliver a replacement guaranty unless the foreclosure 'results in the removal of any guarantor, pledgor, or other obligors under the Senior Loan Documents,' which is almost never the case in a mezzanine loan foreclosure.") This article also identifies the risk to the original guarantor of the mezzanine loan, which may continue to have liability under its guaranty even for acts occurring after the mezzanine foreclosure.

borrower's carveout obligations.[19] Moreover, the prophylactic impact of the carveout obligations would be eliminated if the carveout guarantor were not a party that could control the conduct of the senior borrower and prevent the "bad acts" that the carveouts are intended to discourage. By providing that a replacement guarantor must undertake obligations under a replacement guaranty only if the original guarantor is "removed" as a result of the transfer of or assumption of control over the Equity Collateral, rather than plainly mandating the delivery of a replacement guaranty in connection with the transfer of or assumption of control over the Equity Collateral, the CMBS form facilitates a scenario where the original guarantor, who—as a result of the transfer of or assumption of control over the Equity Collateral resulting from the mezzanine lender's enforcement actions—no longer controls the senior borrower, would remain on the hook for bad acts over which it has no control, while the controlling persons for the senior borrower after the transfer of or assumption of control over the Equity Collateral resulting from the mezzanine lender's enforcement actions can avoid any recourse consequences from "bad acts" that they mandate. This scenario does not properly align the risk of recourse with the control over the senior borrower, and senior lenders should consider addressing this issue in intercreditor agreements in the future in a way that would provide an appropriate alignment between recourse and control.[20]

[19] For an overview of the cases that have decided questions based on springing recourse carveout guarantees, see, Wallenstein, "An Updated Report and Analysis on Springing Recourse Guaranties in Mortgage Loan Transactions," available at http://www.americanbar.org/content/dam/aba/publications/rpte_ereport/2011/2011_aba_rpte_ereport_03_re_wallenstein.authcheckdam.pdf, and Zagoren, Boltryk, Hackman, "Testing the Limits of Recourse Carve-Out Guaranties," 25 Real Est. Fin. J. 4 (Spring 2010). Several cases have addressed non-recourse carve-out guarantees, with results that consistently have been quite favorable to lenders. These cases include Blue Hills Office Park LLC v. J.P. Morgan Chase Bank, 477 F. Supp. 366 (D. Mass 2007) (guarantors held liable for full amount of loan under provision for full springing recourse in the event of a transfer of the mortgaged property; in this case, the transferred "mortgaged property" consisted of settlement proceeds with respect to a zoning dispute); CSFB 2001-C-4 Princeton Park Corporate Center, LLC v. SB Rental I, LLC, 2009 N.J. Super. LEXIS 199 (N.J. Super. Ct. App. Div. 2009) (guarantors held liable as a result of subordinate mortgage obtained without the lender's consent, even though the subordinate loan was repaid); GCCFC 2006-GG7 Westheimer Mall, LLC v. Edward H. Okun, 2008 U.S. Dist. LEXIS 64152 (S.D.N.Y. 2008) (guarantor liable for the full amount of the loan under provision for full springing recourse in the event of a voluntary bankruptcy petition by borrower); 111 Debt Acquisition LLC v. Six Venture, Ltd., 2009 U.S. Dist. LEXIS 11851 (E.D. Ohio) (guarantor liable for the full amount of the loan under provision for full springing recourse in the event of a voluntary bankruptcy petition by borrower); Diamond Point Plaza Limited Partnership v. Wells Fargo Bank, N.A., 929 A. 2d 932 (Md. 2007) (guarantors held liable for full amount of loan under provision for full springing recourse in the event of the borrower's misapplication of rents after default or, alternatively, as a result of the borrower's failure to maintain its status as a special purpose entity); LaSalle Bank, N.A. v. Mobile Hotel Properties, LLC 367 F.Supp. 2d 1022 (2004) (guarantors held liable for full amount of loan under provision for full springing recourse in the event of violation of single purpose entity provisions by borrower resulting from amendment to borrower's articles of organization that permitted ownership of multiple assets); and Heller Financial, Inc. v. Lee 2002 WL 1888591 (N.D. Ill. 2002) (guarantors held liable for full amount of loan under provision for full springing recourse in the event of borrower's violation of covenants against additional encumbrances (in this case, tax liens and mechanics' liens)).

[20] Interestingly, the rating agencies traditionally have not focused on the carveout guaranty – and the leverage it provides with respect to the bad acts, including bankruptcy filings -- as a source of structural benefits. Standard & Poors' U.S. CMBS Legal and Structured Finance Criteria does not require a carveout guaranty. Rather, the rating agency approach has been primarily a "cookbook" – type approach, focused on the creation of a special purpose entity borrower, the use of an independent director, obtaining a non-consolidation opinion, and other check-the-box requirements intended to obtain a level of comfort with respect to separateness, non-consolidation and the risk of a bankruptcy filing. This approach has had a mixed outcome. To the extent that lenders have been under the impression that providing for an independent director for the mortgage borrower is a "magic bullet" that will prevent a bankruptcy filing, such impression is misplaced. The court in the Kingston Square Associates case (In re Kingston Square Associates, 214 B.R. 713 (Bankr. S.D.N.Y. 1997) involved a situation in which the charter of a mortgage

There are other respects in which the provisions of the CMBS form are problematic with respect to replacement guarantors.

First, the form is not clear on the timing with which the replacement guaranty would need to be delivered. From the senior lender's standpoint, the delivery of the replacement guaranty should be a clear prerequisite to the consummation of the transfer of the Equity Collateral or other assumption of control over the senior borrower—otherwise, the senior lender will bear the risk that the mezzanine lender would complete its foreclosure and immediately engineer a bankruptcy or other "bad act," before delivering the replacement guaranty that would serve to mitigate that risk.[21]

Second, the form is inconclusive with respect to the party that must deliver the replacement guaranty. That party must be either "the transferee [of the Equity Collateral] or an Affiliate reasonably satisfactory to the Senior Lender." The language is unclear as to whether the senior lender can require an Affiliate to deliver the guaranty if the transferee is not satisfactory to it, or whether the senior lender must accept the guaranty from the transferee. As noted in the discussion, supra, the transferee of the Equity Collateral, if it is the mezzanine lender itself, may be a single purpose entity with no assets other than the mezzanine loan (and, after the transfer of the Equity Collateral, with no assets other than the Equity Collateral). If that party is able to provide the replacement guaranty, then the senior lender will have as its guarantor a party that adds no financial strength in support of the claims of the senior lender beyond the mortgage collateral that the senior lender already holds.

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borrower required the consent of an independent director in order for the borrower to file a voluntary bankruptcy proceeding. In this case, the independent director was associated with the mortgage lender. In refusing to dismiss an involuntary bankruptcy filing that was apparently procured by the borrower's sponsor through dealings with "friendly" creditors, the court questioned the actions and inactions of the independent director, and the independent director's failure to participate in or stay informed regarding the mortgage borrower's affairs. In the General Growth Property cases, the court rejected motions to dismiss voluntary bankruptcy filings by a group of affiliated single purpose entities that were required to have at least one independent director whose consent was necessary for a voluntary bankruptcy filing. In addressing issues raised by several creditors related to the borrower's eleventh hour replacement of the previously-appointed independent directors with a more friendly set of directors, the court stated that "if [the creditors] believed that an independent manager can serve on a board solely for the purpose of voting 'no' to a bankruptcy filing because of the desires of the secured creditor, they were mistaken. As the Delaware cases stress, directors and managers owe their duties to the corporation and, ordinarily, to the shareholders." In addition, the court allowed the bankruptcy filings to go forward on the basis that consideration of the financial status of the entire corporate group was a relevant factor in the filing, notwithstanding that a number of the single purpose entities themselves were not insolvent. In contrast, the cases that have addressed the exposure of a borrower principal under a carveout guaranty, as noted in footnote 19, have generally reinforced the impression that the carveout guaranty can produce substantial adverse consequences to the guarantor if the actions that trigger recourse, including bankruptcy filings, occur, and thus should be a highly effective tool to influence a borrower's behavior. The existence of a carveout guaranty is, of course, not a panacea, and does not preclude scenarios where the guarantor may be induced to authorize a "bad act" notwithstanding the consequences, as appears to have been the case in the Extended Stay situation, where the carveout guaranty with respect to springing recourse upon the borrower's voluntary bankruptcy was capped and it appears that a class of certificateholders agreed to indemnify the sponsor for that capped amount in order to induce the bankruptcy filing. *See* In the Matter of Extended Stay, Inc., 435 B.R. 139 (S.D.N.Y).

[21] It appears to have been the mezzanine lender's strategy on the Stuyvesant Town case to engineer such a bankruptcy, although the reported decision does not indicate whether the mezzanine lender was required to deliver a replacement guaranty.

Third, the form contains no clear requirements with respect to the financial strength of the replacement guarantor. If the replacement guarantor is not the transferee, then it must be "an Affiliate reasonably satisfactory to the Senior Lender." There is no requirement with respect to net worth, liquidity or other financial measures. The reasonableness requirement creates an opportunity for disputes around the suitability of a proposed guarantor. Senior lenders should consider addressing this issue, either with a clearer, and more bright-line, set of requirements in the future or with an approval right based on their sole and absolute discretion.

Subordination of the Mezzanine Loan

The CMBS form contains several provisions relating to the subordination of the mezzanine loan to the senior loan.

Section 8 "subordinates and makes junior" the mezzanine loan, the mezzanine loan documents and the liens and security interest created thereby, and all rights, remedies, terms and covenants, contained therein, to the senior loan, the senior loan documents and the liens and security interest created thereby.

Section 9 contains certain payment subordination provisions. With exceptions for payments resulting from the realization upon the mezzanine lender's collateral, these payment subordination provisions:

- Subordinate the mezzanine lender's rights to payment of the mezzanine loan to the senior lender's rights to payment "by Borrower" of the senior loan;

- Contain the agreement of the mezzanine lender not to accept or receive payments "from Borrower and/or from the Premises" prior to the date that all obligations of Borrower to senior lender under the senior loan documents are paid;

- Provide that the senior lender is entitled to receive payment and performance of all amounts due to it before the mezzanine lender is entitled to receive any payment on account of the mezzanine loan if a bankruptcy proceeding shall have occurred or if a "Continuing Senior Loan Event of Default" exists;

- Require the mezzanine lender to turn over to the senior lender any payments that are received by the mezzanine lender contrary to the provisions of the intercreditor agreement; and

- Include an overriding provision, under which the mezzanine lender, notwithstanding anything to the contrary contained in the intercreditor agreement (including the foregoing payment subordination provisions), may accept payments which the mezzanine borrower is obligated to pay under the mezzanine loan documents, provided that no Event of Default then exists under the senior loan documents.

Although these provisions are generally favorable to the senior lender, there are respects in which these provisions seem to contain internal inconsistencies, and further clarification of these provisions may be advantageous from the senior lender's standpoint.

For example, the CMBS form of intercreditor agreement involves payment subordination provisions that relate to payments from the senior borrower, thus creating an opportunity for the mezzanine lender to argue that the subordination provisions do not block payments that are made by the borrower sponsor or from other sources. Moreover, in practice, the subordination provisions not infrequently are adjusted so that they apply only to block payments that are sourced from the property. In this respect, the provisions become closer to lien subordination provisions (and closer to the provisions that are applicable in the model form of intercreditor agreement for first and second lien lenders that share collateral), than true payment subordination provisions.[22]

Accordingly, senior lenders should consider tightening up the subordination provisions, so that the subordination obligation relates to any payment, and not just payments from "the Borrower" or "the Premises." Also, given that the subordination provisions permit the mezzanine lender to realize upon its "Separate Collateral," it would be helpful from the senior lender's standpoint to clarify that the rights of the mezzanine lender under the non-recourse carveout guaranty delivered to it are not "Separate Collateral" (if the guarantor thereunder is also the guarantor under the non-recourse carveout guaranty delivered to the senior lender) that the mezzanine lender can pursue without regard to the limits contained in the subordination provisions.

Notwithstanding some of the textual shortcomings in the subordination provisions from the senior lender's standpoint, the one case that has addressed these provisions reached conclusions that are quite favorable to the senior lender. In Highland Park CDO I Grantor Trust, Series A v. Wells Fargo Bank, N.A., as Trustee, 2009 U.S. Dist. LEXIS 53272 (S.D.N.Y 2009), the mortgage lender sought a declaration that the mezzanine lender should be barred from asserting a claim against a guarantor under a principal guaranty prior to the full repayment of the senior loan, while the mezzanine lender sought a declaration that the mezzanine lender had the right to bring suit against the guarantor, irrespective of whether the senior loan was fully paid. Based on the reported case, it appears that the lenders had entered into an intercreditor agreement that contained provisions tracking the subordination provisions of the CMBS form. In its decision, the court dismissed arguments that some of the subordination language only related to the agreement of the mezzanine lender not to accept payments from the senior borrower, and grounded its decision on the general language that "Senior Lender shall be entitled to receive payment and performance in full of all amounts due or to become due to Senior Lender before Mezzanine Lender is entitled to receive any payment on account of the Mezzanine Loan." In reaching this decision, the court observed that "There is nothing problematic about one sentence of the Intercreditor Agreement relating specifically to payments by the senior borrower and subsequent sentences relating more generally to 'any payment on account of the Mezzanine Loans . . . . The more general language governs under the circumstances here." Based on these provisions, the mortgage lender was granted summary judgment and an injunction against the mezzanine lender, barring the mezzanine lender from exercising any right or remedy under the mezzanine loan guaranty unless the senior lender received payment and performance in full of all

[22] *See* Cummings, Thompson, Paparo, "Back to Basics Banking," 28 Int'l Fin. L. Rev. 90 (Dec. 2008/Jan. 2009).

amounts due under the senior loan. Further clarification of the subordination provisions, to pre-ordain the outcome in the Highland Park case, would be advantageous to senior lenders notwithstanding the favorable result in the case.

Even if the subordination provisions of the intercreditor agreement are entirely favorable to the senior lender, the senior lender should underwrite the senior loan on the basis that the existence of the mezzanine loan in the capital stack will preclude the refinancing of the senior loan without a concurrent refinancing on the mezzanine loan. Effectively, the borrower's inability to repay or refinance the mezzanine loan will mean that the entire capital stack cannot be refinanced. It does not seem feasible to expect that the intercreditor agreement can solve this situation (i.e., force the mezzanine lender to release its lien/claim if the mezzanine loan cannot be refinanced when the senior loan is refinanced), and it also does not seem likely that a new lender would be prepared to replace the senior loan with a new senior loan under circumstances where the mezzanine loan has matured but has not been (and will not be) repaid. Consequently, the senior lender should understand as an underwriting matter that this scenario will likely lead to a senior loan foreclosure (or bankruptcy), unless a restructure acceptable to all participants in the capital stock can be accomplished.

Restrictions on Modification of the Senior Loan

The CMBS form approaches the approval rights of the mezzanine lender with respect to senior loan modifications from several perspectives.

First, the form defines "Senior Loan Modification" in a very broad way, as follows: "any amendment, deferral, extension, modification, increase, renewal, replacement, consolidation, supplement or waiver of the Senior Loan or the Senior Loan Documents."

Second, Section 7(a) of the form permits the senior lender to enter into a Senior Loan Modification unless it is specifically restricted from doing so pursuant to the form.

Third, the form grants approval rights to the mezzanine lender with respect to the following Senior Loan Modifications so long as no Continuing Senior Loan Event of Default exists:

(i) increase the interest rate or principal amount of the Senior Loan;

(ii) increase in any other material respect any monetary obligations of Borrower under the Senior Loan Documents;

(iii) extend or shorten the scheduled maturity date of the Senior Loan (except that Senior Lender may permit Borrower to exercise any extension options in accordance with the terms and provisions of the Senior Loan Documents);

(iv) convert or exchange the Senior Loan into or for any other indebtedness or subordinate any of the Senior Loan to any indebtedness of Borrower;

(v) amend or modify the provisions limiting transfers of interests in the Borrower or the Premises;

(vi) modify or amend the terms and provisions of the Senior Loan Cash Management Agreement with respect to the manner, timing and method of the application of payments under the Senior Loan Documents;

(vii) cross default the Senior Loan with any other indebtedness;

(viii) consent to a higher strike price with respect to any new or extended interest rate cap agreement entered into in connection with the extended term of the Senior Loan;

(ix) obtain any contingent interest, additional interest or so-called "kicker" measured on the basis of the cash flow or appreciation of the Premises, (or other similar equity participation); or,

(x) extend the period during which voluntary prepayments are prohibited or during which prepayments require the payment of a prepayment fee or premium or yield maintenance charge or increase the amount of any such prepayment fee, premium or yield maintenance charge.

CMBS form, Section 7(a). [23]

Fourth, even if a Continuing Senior Loan Event of Default exists, the form grants approval rights to the mezzanine lender with respect to the following base-line set of Senior Loan Modifications: any increase in the interest rate or principal amount of the Senior Loan, or extension of the period during which voluntary prepayments are prohibited or during which prepayments require the payment of a prepayment fee or premium or yield maintenance charge, or increase in the amount of any such prepayment fee, premium or yield maintenance charge. CMBS form, § 7(a).

The CMBS form provides a safe harbor for the funding of Protective Advances and interest accruals or accretions and any compounding thereof (including default interest), which are not deemed to be modifications that require the consent of the mezzanine lender.

The system with respect to Senior Loan Modifications that is created under the CMBS form creates several vulnerabilities from a senior lender's standpoint.

Senior lenders should understand that, while the mezzanine lender's cure rights remain available, the CMBS form blocks the senior lender from entering into a Senior Loan Modification. The definition of "Senior Loan Modification" is broad enough to include ordinary course waivers and consents that do not increase the obligations of the senior borrower so long as they fall within the proscriptions in the CMBS form. Senior lenders should consider overriding this definition so that decisions on the part of the senior lender to waive or refrain from declaring or enforcing any event of default under the senior loan, to grant forbearances or extensions for performance, to

[23] In many transactions, this list is negotiated so as to expand the group of modifications with respect to which the mezzanine lender has approval rights.

waive covenants, to grant consents, to take other steps that diminish the applicable obligor's obligations under the senior loan, or to enter into amendments which do not materially increase the obligations of the senior borrower, will not be treated as "Senior Loan Modifications" that require any consent of the mezzanine lender.

Senior lenders should take a harder look at the notion that, even if the mezzanine lender is not curing senior loan defaults, the mezzanine lender should continue to have approval rights with respect to the base-line set of Senior Loan Modifications identified above. It would seem that strong arguments can be made that the senior lender should be free to enter into any modification of the senior loan at a time when the mezzanine lender is not curing defaults (with a possible exception if the mezzanine lender has duly exercised its purchase option described infra).

In practice, many mezzanine loans have been documented based on a set of documents, covenants or provisions that mirror the documentation for the senior loan. Accordingly, it is highly likely that, if a modification of the senior loan is needed, then a mirror-image modification of the mezzanine loan will also be needed. Senior lenders should understand that, even though they may be prepared to enter into a modification of the senior loan, they have no power to force the mezzanine lender to enter into a comparable modification of the mezzanine loan. The CMBS form includes no "drag along" provisions that would empower the senior loan to force the mezzanine lender to do so.[24]

Finally, senior lenders should understand that the intercreditor agreement does not necessarily contain, within its four corners, all documentation that may impact the approval rights that the mezzanine lender may have over senior loan modifications. The mezzanine loan documents themselves may include approval rights of the mezzanine lender over any and all senior loan modifications, and over further actions such as transfer in lieu of foreclosure to the senior lender. It is possible that a violation of these types of mezzanine loan provisions may even create recourse exposure to the mezzanine borrower's sponsor pursuant to the non-recourse carveout guaranty delivered to the mezzanine lender. The existence of these types of provisions will have a chilling effect on the willingness of the borrower sponsor to undertake any modification of the senior loan without the consent of the mezzanine lender. From the senior lender's standpoint, it would be very useful to override the mezzanine lender's rights in the mezzanine loan documents, so that the mezzanine lender's rights under the intercreditor agreement are the exclusive rights of the mezzanine lender with respect to senior loan modifications.

The Mezzanine Lender's Purchase Option

Section 13 of the CMBS form provides a purchase option in favor of the mezzanine lender. This option first becomes exercisable if the senior loan has been accelerated, an Enforcement Action has been commenced and is continuing under the senior loan documents, or the senior loan has become a "specially serviced mortgage loan" under the applicable pooling and servicing agreement.

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[24] The model form of intercreditor agreement for first and second lien lenders includes "drag-along" provisions whereby amendments to the first lien collateral documents made by the first lien lenders automatically apply to the corresponding provisions of the second lien documents. This drag-along concept only applies to collateral documents, and not to covenants. *See* Report of the Model First Lien/Second Lien Intercreditor Agreement Task Force, ABA Committee on Commercial Finance, 65 Bus. Law. 809 at § 2.3, (2010).

As compared to many other options, this purchase option has several unique features.

First, the option is "free." The mezzanine lender does not have to pay any option consideration either in connection with the initial grant of the option or in connection with the exercise of the option. No good faith deposit or down payment is required, even in connection with the exercise of the option. The CMBS form also does not set forth any contractual consequences for the circumstance where the mezzanine lender has exercised the option, but then fails to consummate the purchase.

Second, the option has an open-ended term. Because of the very broad definition of "Enforcement Action" in the CMBS form, the exact date on which the term of the option commences may be shrouded in ambiguity. Then, it continues in effect until there has been a foreclosure under the senior loan or a deed in lieu of foreclosure. In mortgage jurisdictions where a judgment of foreclosure must be obtained, the term of this option is potentially several years in length. As an interesting point of comparison, the model form of intercreditor agreement for use in connection with first and second lien financings provides for a 60-day option term.[25]

Third, by definition, because the senior lender has accelerated or commenced an Enforcement Action, the option is exercisable only under circumstances where the mezzanine lender has chosen not to cure the defaults on the senior loan. Arguably, the option provides a second bite at the apple for a mezzanine lender that has chosen not to cure.

Fourth, the option continues in effect regardless of intervening conduct on the part of the mezzanine lender, and regardless of whether the mezzanine lender is in compliance with its obligations under the intercreditor agreement.

The option appears to be included in the CMBS form on the basis that it results in no skin off the nose of the senior lender. However, a painful lesson that several senior lenders have learned during the current downturn is that the existence of the purchase option in the intercreditor agreement creates arguments, in the event of a bankruptcy filing on the part of the mezzanine lender, that the purchase option is an executory contract of the debtor in the bankruptcy proceeding which cannot be terminated without obtaining relief from the automatic stay in the mezzanine lender's bankruptcy case. As a result, senior lenders have needed to obtain relief from stay in the mezzanine lender's bankruptcy case in order to proceed with their mortgage foreclosure.[26]

The open-endedness of the mezzanine lender's purchase option compounds this risk. If a purchase option must be granted in an intercreditor agreement, senior lenders should consider structuring this option so that it has a finite term, so as to minimize the period over which a mezzanine lender's bankruptcy, or other adverse developments, could adversely affect the senior lender's ability to foreclose as a result of the existence of the option.

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[25] *See* Report of the Model First Lien/Second Lien Intercreditor Agreement Task Force, ABA Committee on Commercial Finance, 65 Bus. Law. 809 at § 5, (2010).

[26] This author is aware of several situations in which relief from stay needed to be obtained in the Lehman Brothers bankruptcy on these grounds.

Miscellaneous Provisions

In the course of the current downturn, senior lenders have found themselves dealing with various claims from mezzanine lenders. In a number of cases, in light of the severe impairment in values that have characterized the downturn in certain markets, it has seemed that the mezzanine lender is making the bet that its prospects of recovery through asserting claims against the senior lender exceed the recovery it might obtain by foreclosing on the equity collateral for the mezzanine loan or otherwise enforcing the mezzanine borrower's loan obligations. These claims have been based on various contract law and tort theories.

The CMBS form includes a number of provisions that are intended to reflect that each of the parties to the intercreditor agreement is sophisticated, has made its own independent decisions, has not relied on information provided by the other lender, and will make its own decisions going forward, and that neither lender owes a fiduciary duty to the other lender. See, e.g., CMBS form, §§ 10(a) and 34(a).

However, these provisions have not prevented mezzanine lenders from making claims against senior lenders in a number of instances.[27] Senior lenders should consider whether it would be appropriate to include additional provisions in future intercreditor agreements in order to bolster their position with respect to potential mezzanine lender claims. Examples of the types of provisions that could be considered would be (i) obligations of the mezzanine lender, following a senior loan event of default that has not been cured, not to contest, hinder or interfere with the senior lender's remedies; (ii) limitations on special, consequential and punitive damages; (iii) provisions to clarify that the senior lender owes no duty of care to the mezzanine lender, that the senior lender should have no liability to the mezzanine lender for ordinary negligence and that actions taken by the senior lender in the course of the administration of the senior loan do not involve "interference" with the mezzanine loan or the prospective economic advantage of the mezzanine lender; (iv) clarification that the senior lender has no duty to the mezzanine lender to protect or insure the property; (v) clarification that the mezzanine lender has no right to rely upon any agent or consultant of the senior lender; (vi) exculpation of the officers, directors, shareholders, members, managers, and agents of the senior lender from any personal liability to the mezzanine lender for any actions in connection with the senior loan or the project; and (vii)

[27] A case which Hudson Realty Capital LLC filed against Bank of New York Mellon Corp. provides an example of the strategy that some mezzanine lenders have pursued, based on the assertion of claims against the senior lender when the mezzanine lenders' rights against the mezzanine borrower may be worthless. In that case, Hudson, the mezzanine lender, argued that Bank of New York Mellon, the senior lender, owed it a fiduciary duty due to its "superior knowledge" of the status of the development and costs relating to a construction project, and knew or should have know that Hudson would rely on allegedly inaccurate or misleading information prepared by the Bank's construction consultant. The mezzanine lender also attempted to characterize the senior lender's course of conduct in connection with alleged mismanagement of the project as involving a "modification" of the senior loan that violated the provisions of the intercreditor agreement which granted approval rights to the mezzanine lender with respect to senior loan modifications. These claims were dismissed by the New York Supreme Court in an unreported decision. *See* "Chopped Down," The Daily Deal, January 27, 2010. Other mezzanine lenders have asserted claims based on theories of tortious interference or collusion. *See* In the Matter of Extended Stay, Inc., 435 B.R. 139 (S.D.N.Y., September 7, 2010), in which a mezzanine lender asserted not only claims against the guarantor based on the provisions of a non-recourse carveout guaranty that were triggered by a bankruptcy filing, but also claims against certain more senior creditors, which had agreed to indemnify the guarantor for the liability that it would have under the mezzanine non-recourse carveout guaranty as a result of the bankruptcy filing.

provisions that would suspend the rights and options of the mezzanine lender under the intercreditor agreement if the mezzanine lender is not in compliance with its obligations under the intercreditor agreement.

In addition, the CMBS form lacks ordinary boilerplate provisions for venue, submission to jurisdiction and waiver of jury trial. The lack of these provisions has resulted in tactical disadvantages to a number of senior lenders in various cases commenced by mezzanine lenders. Senior lenders should consider including appropriate provisions to address these issues in intercreditor agreements in the future.

Conclusion

Throughout the cycle leading up to the recent downturn in the real estate market, participants in real estate financing transactions involving mortgage and mezzanine tranches frequently approached the negotiation of the intercreditor agreement on the basis that that the CMBS form reflected “market” terms, and thus did not need to be re-considered with a critical eye in the context of each new transaction. From a senior lender’s standpoint, approaching the negotiation of an intercreditor agreement in this “one-size-fits-all” way risks ignoring the blind spots and shortcomings in the CMBS form. The experience of lenders with the CMBS form during the downturn should provide a number of lessons learned for consideration in future transactions. Whether the suggestions contained in this article will be considered by parties providing mezzanine financing to be workable or to be within the risk profile that their pricing supports, are questions that should be played out on a transaction-by-transaction basis.