



At the same time, EHP granted a mortgage on the property to Capstone that included Joseph Leach's limited personal guaranty of the note. Leach has an ownership interest in and directs operations of four companies: Euclid Housing Partners, Ltd., JRL Holdings, Inc., Independence Office Associates and Leach Construction Company.

Wells Fargo obtained the note, mortgage, guaranty and other related documents by assignment. The note is a non-recourse loan but there are "carve-out" provisions which under certain circumstances allow recourse to the borrower (EHP) and, in turn, the guarantor (Leach) of the loan. The provisions in question concern misappropriation of insurance proceeds, holding rents in escrow after a payment default, and a prohibition on assuming debt other than trade debt on the property (the single-purpose entity requirement).

Three events triggered recourse liability by EHP and Leach. First, in 2009, EHP received insurance proceeds for units that suffered water and fire damage. EHP failed to fully apply the proceeds to all needed repairs and did not turn over the unapplied money to Wells Fargo as required in the note and mortgage, but instead used a portion of the money to repair the damaged units, while apportioning the remaining funds to the loan and other bills. Second, EHP failed to hold in trust rents that were collected after it defaulted on the note. Third, at some point before September 2009, EHP borrowed money from two Leach-controlled entities – \$85,000 from Independence and \$108,532 from Leach Construction – to pay on the note and for other expenses. After defaulting on the loan, EHP paid a total of \$60,000 to Independence as repayment for the \$85,000 loan and continued to pay money to Leach Construction.

### **THE LOAN DOCUMENTS**

against Borrower under this Note and the other Loan Documents shall be limited solely to the

Property and the ‘Collateral’ (as defined in the Mortgage).” In other words, the loan is a non-recourse loan. However, section 8.2 describes circumstances that create exceptions, or “carve-outs,” to section 8.1’s non-recourse provision. Three explicit carve-outs at sections 8.2(a)(iv) and (vi), and 8.2(c) and a catch-all provision at the end of section 8.2 are most relevant to this case, and state as follows, with emphasis in italics added:

**8.2 Exceptions.** Notwithstanding anything to the contrary contained in Section 8.1 or elsewhere in this Note or the other Loan Documents, Borrower shall be personally liable to the Lender:

(a) *for any liabilities, costs, expenses (including reasonable attorney’s fees and expenses), claims, losses or damages incurred by Lender . . . with respect to any of the following matters:*

\* \* \*

(iv) *failure to deliver any insurance or condemnation proceeds or awards or any security deposits received by Borrower to Lender or to otherwise apply such sums as required under the terms of the Loan Documents or any other instrument now or hereafter securing this Note; or*

\* \* \*

(vi) *failure to apply any rents . . . and other benefits from the Property which are collected or received by Borrower . . . either during the period of any Default, or after the occurrence of any event which with the giving of notice or the passage of time, or both, would constitute a Default, or after acceleration of the indebtedness and other sums owing under the Loan Documents, only to the payment of either such indebtedness or other sums, or the normal and necessary operating expenses of the Property.*

\* \* \*

(c) for all fees and other collection costs (including without limitation attorneys’ fees and/or expert witness fees) reasonably incurred by Lender in any legal . . . proceeding . . .

\* \* \*

Additionally, notwithstanding anything to the contrary contained in Section 8.1 of this Note or the other Loan Documents, *if . . . (z) Borrower shall (1) incur any debt, secured or unsecured, direct or indirect, absolute or contingent (including guaranteeing any obligation), other than the Loan or trade debt incurred in the ordinary course of Borrower’s business which shall be paid in accordance with the terms of the Loan Documents, . . . or Borrower shall otherwise fail to maintain all of the single- attached to the Mortgage, then Lender shall have the right to seek a personal judgment against Borrower on this Note and under any other Loan Documents with respect to any and all indebtedness secured thereby.*

Section 2 of Exhibit B to section 7.1(a)(viii) of the mortgage has its own concomitant to section 8.2 of the note's single-purpose entity carve-out. The relevant portion of section 2 states:

Mortgagor shall not incur any debt, secured or unsecured, direct or indirect, absolute or contingent (including guaranteeing any obligation), other than the Loan and trade debt incurred in the ordinary course of Mortgagor's business and the managing member or general partner of Mortgagor shall not incur any debt, secured or unsecured, direct or indirect, absolute or contingent (including guaranteeing any obligation).

Finally, by the personal guaranty, Leach agreed to be personally responsible for EHP's liabilities to the lender for failure to pay over insurance proceeds (section 1(a)(iv) of the guaranty), failure to apply rents (section 1(a)(vi) of the guaranty), and if EHP incurs any debt other than the loan or trade debt or "otherwise fail[s] to maintain all of the single-purpose entity requirements set forth in Exhibit 'B' attached to the Mortgage, then lender shall have the right to seek a personal judgment against Borrower on this Guaranty and under any other Loan Document with respect to any and all indebtedness secured thereby."<sup>2</sup>

### **THE LAWSUIT**

Having been alerted by a prior lawsuit that Wells Fargo expected recourse to EHP and Leach personally for the unpaid loan amount, the plaintiffs, on January 29, 2010, filed the complaint in this case seeking a declaratory judgment that EHP never violated the single-purpose entity requirement of the loan documents, and that the plaintiffs are not personally liable for the loan because the "carve-out" provisions that create exceptions to the non-recourse nature of the loan in the note, mortgage and guaranty have not been triggered.<sup>3</sup>

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<sup>2</sup> Last paragraph of section 1 of the guaranty, page 2.

<sup>3</sup> The plaintiffs also sought a declaratory judgment that the mortgage was invalid because it was defectively executed, but that claim was dismissed on September 8, 2010.

Wells Fargo counterclaimed for breach of contract by EHP, foreclosure on the real estate and other collateral, and for a judgment against Leach on the guaranty.<sup>4</sup>

The defendant has moved for partial summary judgment on its claims for money judgments against EHP and Leach personally and for declaratory judgments in its favor on the remaining counts of the plaintiffs' complaint.<sup>5</sup>

### **LAW AND ANALYSIS**

Plaintiffs first claim that Wells Fargo is not the real party in interest because it has insufficiently proven the several assignments by which it claims to have become not only the noteholder, but the party with the right to enforce the mortgage and personal guaranty. Because there is no genuine issue of material fact about the existence, validity or extent of the assignments, this argument is without merit.

The loan documents were first assigned by Capstone to Bridger Commercial Funding, LLC, then by Bridger to Bank of America, N.A., from Bank of America to LaSalle Bank N.A., as trustee *etc.*, and finally from LaSalle to the defendant Wells Fargo. The documents attached as exhibits to Wells Fargo's counterclaim and reply to the plaintiffs' brief in opposition to summary judgment are sufficient to prove these assignments and the plaintiffs, while questioning the admissibility of the documents, have not produced evidence suggesting the assignments never occurred or were otherwise invalid. But the plaintiffs do raise the particular objection that the counterclaim exhibits do not identify the mortgage and guaranty as part of the assignment from LaSalle to Wells Fargo. However, the omnibus assignment by which Wells Fargo claims its right to enforce the three loan documents refers to the assignment of

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<sup>4</sup> Wells Fargo has also asserted fraudulent transfer claims against the other Leach companies but those claims are not part of the pending motion.

<sup>5</sup> The property has since been sold at a receiver's sale but the claims in the motion for summary judgment are still

*all right, title and interest of [LaSalle] in and to the loan identified on Exhibit A attached hereto (the “Loan”), including without limitation all of [LaSalle’s] right, title and interest in any claims, collateral, insurance policies, certificates of deposit, letters of credit, escrow accounts, performance bonds, demands, causes of action and any other collateral arising out of and/or executed and/or delivered in or to or with respect to the Loan, together with any other documents or instruments executed and/or delivered in connection with or otherwise related to the Loan.* (Emphasis in italics added.)

There is no question that the “other documents or instruments executed” in connection with the loan include the mortgage and Leach’s personal guaranty, and the defendant is the real party in interest on all of those loan documents.

The plaintiffs’ second argument against summary judgment is that, although EHP did default on the loan, the defendants have not offered proof of damages, thereby precluding summary judgment because an element of a breach of contract cause of action has not been shown. The plaintiffs assert that “[l]iability cannot be established without a finding of damages, yet that is exactly what Defendant is requesting in its Motion.”<sup>6</sup> But Rule 56(D) of the Ohio Rules of Civil Procedure specifically contemplates a “summary judgment [that] is not rendered upon the whole case” and provides that, in such an event, a trial will be held where certain issues have been resolved by summary judgment and others are left for the finder of fact at trial. The plaintiffs’ argument also ignores that two of the claims for which the defendant seeks summary judgment are the plaintiffs’ own claims for declaratory judgment. If there are no genuine issues of material on certain matters the court should not be precluded from partially declaring the rights and obligations of the party and leaving the rest for a trial.

As support for their position, the plaintiffs cite *DeCastro v. Wellston City School Dist. Bd. of Ed.*<sup>7</sup> In *DeCastro*, a high school student claimed breach of contract after receiving an in-school suspension. Unlike Wells Fargo, the plaintiff in that case was unable to point to even

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<sup>6</sup> Br. in opp., p. 15.

<sup>7</sup> (2002), 94 Ohio St.3d 197.

the possibility of monetary damages. While the amount of damages arising from the failure to pay over rent or insurance proceeds, or from breaching the single-purpose entity provisions of the loan documents, may vary depending on the resolution of disputed facts, it cannot be said that it is impossible that the plaintiffs' breaches caused economic damage to the defendant and *DeCastro's* logic is inapplicable here.

The plaintiffs' next argument is that even if the defendant can prove damages from EHP's violation of the single-purpose limitation, Leach cannot be personally liable under the guaranty because it only provides, in that circumstance, that Wells Fargo "shall have the right to seek a personal judgment against the Borrower"<sup>8</sup> and not the guarantor. While that is what the guaranty says, it also says that Leach agrees to pay "all sums for which Borrower is now or hereafter liable to Lender"<sup>9</sup> by virtue of EHP violating the note's carve-out provisions. Simply put, the effect of the guaranty is that Leach agreed to pay any full-recourse liability incurred by EHP, and the only way that could occur is by EHP's violation of a carve-out provision.

The plaintiffs' penultimate objection to summary judgment is that the catch-all carve-out provisions in the note and guaranty render the note's non-recourse provision illusory and, therefore, unenforceable. The plaintiffs assert that giving the mortgagee discretion to declare optional defaults "swallow[s] the non-recourse provisions in their entirety, at the option of"<sup>10</sup> Wells Fargo. Like the preceding arguments, this one is also unavailing.

A contract is based on an illusory promise when one party retains "an unlimited right to determine the nature or extent of his promise." This right destroys the promise, rendering it illusory.<sup>11</sup> Article 7.1(a) of the mortgage lists eight "optional defaults" that trigger personal

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<sup>8</sup> Last paragraph of section 1 of the guaranty, p. 2.

<sup>9</sup> First paragraph of section 1 of the guaranty, p. 1.

<sup>10</sup> Br. in opp., p. 19.

<sup>11</sup> *State v. Taylor* (2009), 6th Dist. No. 4727835, 2009-Ohio-6496, ¶28.

recourse to the mortgagor, one of which is violation of the single-purpose entity requirement. Far from giving the noteholder an unlimited right to declare all sums due and payable under the mortgage, the mortgage only allows for default upon the occurrence of these eight certain events. Exceptions to the non-recourse provision are just that – exceptions – and only qualify the non-recourse provision but do not make it illusory.

Finally, plaintiffs contend that allowing recourse to them personally for the full amount of the loan in the event of a violation of the single-purpose restriction is akin to a liquidated damages clause and contravenes public policy because it amounts to a punishment. That is not the case. By the loan documents, the lender, EHP and Leach agreed that the loan was non-recourse except if the borrower did certain things, including violating the single-purpose restriction, in which event the borrower (and guarantor) agreed to full recourse. The plaintiffs agreed to the catch-all carve-out unconditionally, *i.e.* not only to the extent the noteholder could prove damage from the offending conduct. Hence, if the single-purpose entity restriction is honored, there will be no personal recourse for the whole loan; if it isn't, there will.

Nor can the plaintiffs avoid the result of their conduct by claiming that they breached the contract for a good reason, namely to continue making timely payments on the note. The contract documents do not exempt from the single-purpose entity restriction an act undertaken only to allow EHP to meet its obligations to Wells Fargo.

### **CONCLUSION AND DECLARATORY JUDGMENT**

For all of the foregoing reasons, the  
granted in all respects and judgment is entered in favor of Wells Fargo Bank, as Trustee for the  
holders of Banc of America Commercial Mortgage Inc. Commercial Mortgage Pass-Through

Certificates, Series 2004-4, acting by and through Orix Capital Markets, LLC as its special servicer, on its first and fifth causes of action as follows:

On count one for breach of contract, there is no genuine issue of material fact about whether Euclid Housing Partners, Ltd. breached the terms of the note and mortgage. In particular, EHP breached section 8.2(a)(iv) of the note by failing to deliver to Wells Fargo insurance proceeds it received or to otherwise apply all such proceeds to repair the damage for which the insurance proceeds were paid. EHP also breached section 8.2(vi) of the note by receiving rental payments after defaulting on the note's repayment provisions in September 2009 and then failing to apply those payments only to the indebtedness on the note or to the normal and necessary operating expenses of the property. EHP also breached the single-purpose restriction near the end of section 8.2 of the note and the similar restriction in section 7.1(a)(viii) and Exhibit B of the mortgage by incurring debt other than the note or trade debt incurred in the ordinary course of the business, specifically the loans from Leach Construction and Independence Office Associates.

By virtue of the violations of sections 8.2(iv) and (vi), EHP is liable to Wells Fargo, as trustee, *etc.* for whatever damages may be shown by Wells Fargo at trial, by a preponderance of the evidence, to have been proximately caused by the breaches. By virtue of the violation of the single-purpose restriction of sections 8.2 (of the note) and 7.1(a)(viii) (of the mortgage), EHP is liable to Wells Fargo, as trustee, *etc.* mortgage that remains outstanding, in an amount to be shown by Wells Fargo at trial by a preponderance of the evidence.

On count five for liability by plaintiff Leach on the personal guaranty, having found that EHP breached the terms of the note and mortgage and is subject to a damages judgment in

Wells Fargo's favor upon sufficient proof at trial, there is no genuine issue of material fact to prevent Leach from being personally subject to any such judgment.

On count two of the plaintiffs' complaint for declaratory judgment, the court finds that Euclid Housing Partners, Ltd. did default on the terms of the mortgage by violating the single-purpose entity requirements of section 7.1(a)(viii) and Exhibit B to the mortgage when it accepted loans from Leach Construction and Independence Office Associates for purposes other than repaying the note or ordinary trade debt.

On count three of the plaintiffs' complaint for declaratory judgment, the court finds that Euclid Housing Partners, Ltd. did default on the terms of the mortgage and note in the manner outlined in the preceding four paragraphs.

Therefore, for its declaration of the rights and obligations of the plaintiffs and defendant, the court finds that Wells Fargo, as trustee, *etc.* has the right to pursue personal judgments against EHP and Leach at a trial on its counterclaims and that EHP and Leach are personally obligated to pay any amounts that Wells Fargo proves, by a preponderance of the evidence, are owed to it: 1) for whatever damages were proximately caused by the breaches of sections 8.2(iv) and (vi) of the note; 2) for all indebtedness secured by the note and mortgage that remains outstanding; and 3) for all fees and other collection costs (including without limitation attorneys' fees and/or expert witness fees) reasonably incurred by Wells Fargo in this proceeding.<sup>12</sup>

**IT IS SO ORDERED:**

\_\_\_\_\_  
Judge John P. O'Donnell

Date: \_\_\_\_\_

<sup>12</sup> If the parties cannot stipulate to the amount of fees and collection costs – a stipulation that can include non-waiver by EHP and Leach of their right to appeal this ruling – then an evidentiary hearing on these amounts will be held after a trial on the other damages.

**CERTIFICATE OF SERVICE**

A copy of this journal entry was sent by e-mail on the \_\_\_\_\_ day of January, 2012, to the following:

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Judge John