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Cherryland Mall and the Limits of “Non-Recourse” Carveouts

This is the second installment of our blog, [The Carveout](#), where we explore non-recourse carveouts, one of the most negotiated and critical items in commercial real estate finance (CREF) and lending. For background on the topics covered here, check out our prior post on [carveout provisions in CREF and how to leverage them](#).

SPE Covenants and Cherryland

Commercial mortgage-backed securities (CMBS) lenders, life insurance companies, portfolio lenders, debt funds, and some other lenders commonly provide “non-recourse” loans for stabilized, income-producing properties. In a pure non-recourse structure, the individual sponsor and equity owners are not personally liable for the debt, and the lender’s sole remedy following a default is to foreclose the property securing the loan. However, nearly every non-recourse loan contains carveouts, where liability will be triggered for the borrower’s principals or guarantors if certain events occur. Though often regarded as covering only “bad-boy” acts like fraud, these provisions often capture much broader conduct. Depending on the language, a particular carveout can either create (1) loss liability for the lender’s actual losses or (2) full-recourse liability for the entire amount of the loan.

Among these carveouts are a series of covenants requiring the borrower to be and remain a [special purpose entity](#) (SPE). These provisions are intended to ensure the legal isolation of the asset, the financial separation of the asset’s cash flows, and the observance of other corporate formalities—all with the aim of preventing the relevant entity and asset from being consolidated into the bankruptcy of a parent company or other affiliate. While often treated as boilerplate, the potential consequences of violating SPE covenants were illuminated in the infamous 2011 *Cherryland Mall* case.

In *Wells Fargo Bank v. Cherryland Mall*, the Michigan Court of Appeals held that the borrower of a CMBS loan violated its SPE covenants by becoming insolvent. Importantly, the insolvency was not caused by any borrower misconduct, but instead by a broad decline in commercial real estate asset values during the Global Financial Crisis. Nevertheless, the court held that insolvency alone breached the loan's SPE covenants, which required that the "[m]ortgagor is and will remain solvent and...will pay its debts and liabilities...from its assets as the same shall become due." By narrowly interpreting the literal language in isolation from the broader commercial context, the appeals court triggered full-recourse liability against the borrower's principals under the non-recourse carveouts. This strict interpretation of the loan documents disregarded industry assumptions underlying non-recourse lending, blindsiding many sponsors who understood recourse to be reserved for "bad-boy" acts like fraud or misappropriation, not insolvency driven by market conditions.

Solvency Requirements in Non-Recourse Loans

In the wake of *Cherryland Mall* and similar rulings, including *Gratiot Avenue Holdings v. Chesterfield Development Company*, some state legislatures stepped in to reinforce the commercial understanding of non-recourse lending. Michigan and Ohio enacted statutes making post-closing solvency covenants in past and future non-recourse loans invalid and unenforceable as a recourse-triggering event.

Though more than a decade has passed, the core issues in *Cherryland Mall* continue to shape how market participants negotiate loan documents. Solvency language in non-recourse loans is no longer treated as boilerplate but is now carefully negotiated to preserve the intended risk allocation between borrower and lender. SPE covenants that require a borrower to remain solvent or provide for the payment of future obligations now often include, or are negotiated to include, language stating that the borrower "intends to remain solvent," that obligations are "subject to sufficient cash flow being generated by the property," and that SPE provisions "shall not be deemed to require any member or other owner of an

interest in Borrower to make additional capital contributions.” These modifications are essential to mitigating the risk posed by *Cherryland Mall* and similar cases creating recourse liability where none was intended.

Broader Carveout Risks

While *Cherryland Mall* focused on solvency provisions, the Michigan Court of Appeals’ holding illustrates the broader risk of courts strictly interpreting carveout language as written, even when departing from commercial expectations. As the *Cherryland Mall* court made clear: “it is not the job of this court to save litigants from their bad bargains or their failure to read and understand the terms of a contract.” Under the standard rules of contract interpretation, unambiguous language is given its plain meaning, regardless of the broader commercial context or the parties’ subjective intent.

This approach underscores why it is in the interest of all parties—lenders, borrowers, and guarantors—to exercise heightened awareness while negotiating and drafting carveout provisions. Carveout provisions should be drafted with precision and clarity in a manner that avoids ambiguity wherever possible. Key carveout terms like “insolvency” and “waste” should be negotiated to reflect the parties’ intent, and carveouts that involve the payment of ongoing amounts should likewise be negotiated to reflect the agreed-upon terms. By following these practices at the outset, the parties reduce the risk of a court later interpreting carveout language in a way they never intended. For more information regarding the negotiation of such carveouts, see our post [Carveouts and Cash Flow: Additional Impacts of Cherryland Mall](#).

Now is an especially critical time to take a close look at your loan documents. With a significant maturity wall upon us and a [wave of debt becoming due](#), not to mention new loan originations continuing to occur at a high rate, the language in your carveout provisions could determine whether a loan remains truly non-recourse or will unexpectedly expose borrowers and guarantors to liability.

If you have questions as it relates to the topics addressed above, please contact the authors or any attorney with Frost Brown Todd's [Commercial Real Estate Finance Team](#). And stay tuned to [The Carveout](#) for future blog posts designed to help you better understand recourse carveout liabilities, particularly for deals involving [special purpose entity \(SPE\) provisions](#), and the additional impacts of *Cherryland Mall*.

**[Peyton Cuzzart](#), a rising second-year law student at the University of Louisville Louis D. Brandeis School of Law, contributed to this article while working as summer associate at Frost Brown Todd.*

The Carveout

A legal blog geared toward sophisticated capital market participants, The Carveout provides insight into current trends and developments in commercial real estate finance (CREF)—with a particular focus on non-recourse carveouts and CREF loan platforms including CMBS, debt funds, private capital, REITs, life insurance companies, and other complex sources of capital.

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