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In re Hari Aum, LLC

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In re Hari Aum, LLC, 714 F.3d 274 (5th Cir. 2013)

SYNOPSIS: In an appeal from a bankruptcy court dispute between two mortgagees, the U.S. Court of Appeals for the Fifth Circuit recognized formally that a multiple indebtedness mortgage granted under Article 3298 of the Louisiana Civil Code (“Art. 3298”) has priority from the date of its recordation regardless of when the secured obligation is actually incurred and held that if a multiple indebtedness mortgage is stated to secure the mortgagor’s present and future obligations, it will also secure obligations of a third party assumed by the mortgagor, all with priority from the date of the mortgage’s initial recordation.

FACTS: In 2005, Hari Aum, LLC (“Hari Aum”), an entity wholly owned by Suresh Bhula (“Bhula”), granted a “Multiple Indebtedness Mortgage” (the “MIM”) covering the Deluxe Motel in Slidell, Louisiana, to First Guaranty Bank (“FGB”). This MIM stated that it secured a \$1.8 million dollar purchase money note as well as “any and all other obligations, including, without limitation, [Debtor’s] covenants and agreements in any present or future loan or credit agreement or any other agreement, document or instrument executed by [Hari Aum] and liabilities that [Hari Aum] may now and/or in the future owe to and/or incur in favor of [FGB], whether direct or indirect, ... and whether now existing or hereafter arising ... whether [Hari Aum] is obligated alone or with others on a ‘solidary’ or ‘joint and several’ basis, as a principal obligor or as a surety, guarantor, or endorser, of every nature and kind whatsoever” up to a maximum amount of \$50,000,000. 714 F3d at 277. This sort of clause is often called a “gorilla” clause.

In 2006, after Hurricane Katrina, Hari Aum granted the Small Business Administration (the “SBA”) a second mortgage on the Deluxe Motel to secure a disaster loan.

In 2009, FGB refinanced the original \$1.8 million and a \$4.9 million loan previously made by FGB to another wholly owned Bhula company, Mississippi Hospitality Services, LLC (“MHS”), to finance the acquisition of a Mississippi hotel. As part of the 2009 refinancing, Bhula executed on behalf of Hari Aum an Acknowledgment of Existing Multiple Indebtedness Mortgage (the “Acknowledgment”) that stated that the MIM secured the MHS debt and that Hari Aum would be liable together with MHS for MHS’s note.

Hari Aum and MHS defaulted, and Hari Aum filed a Chapter 11 bankruptcy proceeding. In the bankruptcy proceeding, Hari Aum and the SBA asserted that MIM on the Deluxe Hotel did not secure the MHS debt.

The bankruptcy court held that the MIM secured future loans without recording additional documents, that Bhula had authority to pledge Hari Aum's property to secure MHS's debt, and that the MIM on the Deluxe Motel, together with MHS's promissory note and the Acknowledgment, effected a cross-collateralization of the Deluxe Hotel to secure the MHS debt, with priority from the original recordation of the MIM.

ANALYSIS: Initially, the court observed that Art. 3298, the statute that authorizes multiple indebtedness mortgages in Louisiana, has not been interpreted or applied in a published Louisiana decision, although it has been in effect since 1992. Sections (A) through (C) of this article provide as follows:

Art. 3298. Mortgage may secure future obligations

- A. A mortgage may secure obligations that may arise in the future.
- B. As to all obligations, present and future, secured by the mortgage, notwithstanding the nature of such obligations or the date they arise, the mortgage has effect between the parties from the time the mortgage is established and as to third persons from the time the contract of mortgage is filed for registry.
- C. A promissory note or other evidence of indebtedness secured by a mortgage need not be paraphed for identification with the mortgage and need not recite that it is secured by the mortgage.

Before the enactment of Art. 3298, there was no Louisiana statutory authority for a mortgage that secured future obligations. Louisiana courts instead recognized "collateral mortgages." To create a collateral mortgage, (i) the borrower executed a bearer note in an amount that was much greater than the anticipated debt (a "collateral mortgage note"), (ii) the borrower executed a mortgage securing this collateral mortgage note (the "collateral mortgage"), (iii) the notary public before whom the collateral mortgage was executed paraphed (that is, marked) the collateral mortgage note for identification with the collateral mortgage, and (iv) the borrower executed a pledge document pursuant to which the collateral mortgage note was pledged to secure the current note and all present and future debt. The "gorilla clause" was contained in this pledge document.

Because Art. 3298 was designed to provide a “direct and convenient substitute” for the collateral mortgage, the 5th Circuit panel, like the bankruptcy court, reviewed collateral mortgage authorities in reaching its decision. 714 F.3d at 282 (quoting Art. 3298, Revision Comment (a)). The panel and the bankruptcy court also relied heavily on a Louisiana Law Review article by David S. Willenzik: David S. Willenzik, Future Advance Priority Rights of Louisiana Collateral Mortgages: Legislative Revisions, New Rules, and a Modern Alternative, 55 La. L. Rv. 1 (1994).

Although Hari Aum’s argument really focused on whether the MIM, as written, could secure third party debt without a recorded amendment, the court took the opportunity to point out that Art. 3298 trumps (and incorporates) Louisiana’s strong public records doctrine by permitting a single mortgage to secure future debt without the necessity of putting third parties on notice of the details of the debt through recorded mortgage amendments. 714 F.3d at 284-85. The court then noted that a multiple indebtedness mortgage that states that it secures future, indefinite obligations will not be considered to be invalidated or cancelled if no debt is outstanding at a particular time – even “dry” mortgages remain in effect until they are cancelled by affirmative action. *Id.* at 285-87.

Of course, the real question was whether the future indebtedness language in the MIM was sufficient to permit the cross-collateralization of third party debt.

The court quickly rejected Hari Aum’s argument that Bhula did not have the authority to sign the Acknowledgment on behalf of Hari Aum – it accepted a resolution signed by Bhula as the sole managing member of Hari Aum that granted Bhula the authority to pledge Hari Aum’s real property as security for any indebtedness of Hari Aum to FGB. *Id.*

The court then rejected on two bases Hari Aum’s assertion that the parties should have amended the MIM to permit the mortgage to be used to secure third party debt. First, in the Acknowledgment, Hari Aum agreed to be bound on a “joint and several” or “solidary” basis (the court noted that “solidary” is an alternate term for “joint and several”) for the debts of MHS, and this assumed loan fell within the broad definition of the secured indebtedness in MIM. Second, Hari Aum had pledged the MIM to secure MHS’s indebtedness. For these reasons, the court held that Hari Aum had taken the necessary steps to effect the cross-collateralization of the Deluxe Hotel to secure the MHS debt.

COMMENT: On the general issue of whether a Louisiana mortgage created under Art. 3298 can secure future obligations with priority from the original mortgage without the recordation of amendments to the mortgage recognizing each new debt, *In re Hari Aum* simply provides belated published judicial authority for the now common use of multiple indebtedness mortgages in Louisiana. Of course, in practice, courts have given effect to multiple indebtedness mortgages for many years.

In the 1990s, lenders and lawyers were so used to collateral mortgages that this simplified mortgage form felt suspicious. Many did not want to use something new, and some lenders continued to use collateral mortgages for years after the enactment of Art. 3298 – the cautious word was, “Let’s see how the courts interpret it.” But in day-to-day lending and enforcement, the multiple indebtedness mortgage caught on, and it is now the preferred future indebtedness mortgage form. The fact that the validity of this new form of mortgage (for Louisiana) was not more widely litigated probably stems from the clarity of Art. 3298 and the important commentary of Mr. Willenzik and others (David Willenzik and Mike Rubin also authored *Is the Collateral Mortgage Obsolete?*, 41 La. B.J. 529 (April 1994)).

The Fifth Circuit’s ruling that the “gorilla” language of the MIM plus the Acknowledgment were together sufficient to effect a cross collateralization is correct. As a careful draftsman, I would have used a guaranty or other clearer way of showing that MHS’s debt was now also Hari Aum’s debt and thus clearly within the “gorilla” language that mentioned only Hari Aum’s debt. I would also have drafted the resolution more clearly. Finally, I would also not want to rely on a “pledge” of a multiple indebtedness mortgage by itself for cross-collateralization.

But if the documentation had been perfect, would we have finally had a decision that clearly recognizes the validity of such a useful security device in Louisiana? No, probably not. Consequently, we should be glad that this not-quite-so-perfect documentation caused these questions to be presented to an appellate court after 20 years and answered in a way that recognizes in a formal published decision the validity of current mortgage practice in Louisiana.