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# **Commercial Loan Guaranties: Drafting and Enforcing Corporate and Personal Guaranties and Non-Recourse Carve-Outs**

Best Practices for Lenders and Guarantors In and Outside Bankruptcy

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WEDNESDAY, MARCH 20, 2019

1pm Eastern | 12pm Central | 11am Mountain | 10am Pacific

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Today's faculty features:

Meryl P. Diamond, Partner, **Alston & Bird**, New York

Ren R. Hayhurst, Founder, **Ren RH Legal Consultants**, Costa Mesa, Calif.

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# COMMERCIAL LOAN GUARANTIES: DRAFTING AND ENFORCING

STRAFFORD LIVE CLE WEBINAR  
WEDNESDAY, MARCH 20, 2019

PRESENTED BY:  
MERYL P. DIAMOND, ESQ.  
ALSTON & BIRD LLP  
and  
REN HAYHURST, ESQ.  
REN RH LEGAL CONSULTANTS

# DRAFTING GUARANTY DOCUMENTATION

- I. BORROWER ENTITY TYPES and  
CONSTITUENT OWNER LIABILITY
  - A. Sole Proprietorship
  - B. Corporations: Shareholders and Officers
  - C. Partnerships: Partners
    - i. General Partnerships
    - ii. Limited Partnerships
    - iii. Limited Liability Partnerships
  - D. Limited Liability Companies: Members
  - E. Trusts: Trustees and Beneficiaries

## II. ELIGIBLE GUARANTOR PARTIES

- A. Downstream Guaranties: Guaranties by Direct and Indirect Owners of Borrower
- B. Upstream Guaranties: Guaranties by Subsidiaries of Borrower
  - i. *In Re Touse, Inc. (Official Comm. Of Unsecured Creditors of TOUSA, INC. v. Citi Corp N. Am. Inc.)*, 422 B.R. 783 (Bankr. S.D. Fla. 2009)
- C. Cross-Stream Guaranty: Guaranties by Affiliates of Borrower
- D. “Sham” Guaranties: To be discussed in detail in Enforcement of Guaranties portion of Webinar

### III. TYPES OF GUARANTIES

#### A. Absolute and Conditional Guaranties

- i. Absolute Guaranties (Unconditional)
- ii. Conditional Guaranties (Conditioned upon the occurrence of a contingent event)

#### B. Payment vs. Collection Guaranties

- i. Payment Guaranties: Lender may demand recovery directly from Guarantor.
- ii. Collection Guaranties: Lender must exhaust remedies against Borrower prior to seeking recovery from Guarantor.



## IV. ELEMENTS OF ENFORCEABLE PAYMENT GUARANTIES

- A. Specify that it is a Payment Guaranty
- B. Note Guarantor is a Primary Obligor
- C. Consideration
- D. Identify all Guaranteed Obligations
  - i. Future Extensions of Credit
  - ii. Costs of Enforcement
- E. Joint and Several Liability
  - i. Borrower and Co-Guarantors
  - ii. Effect of Release of Borrower or Co-Guarantor

## IV. ELEMENTS OF ENFORCEABLE PAYMENT GUARANTIES (cont.)

### F. Waivers

- i. General Waivers (Defenses, Counterclaims and Offsets)
- ii. Consent to Amendments
- iii. Notice of Amendments
- iv. Notice of Adverse Matters
- v. Notice of Borrower Default
- vi. Notice of Foreclosure
- vii. State Specific Waivers (*e.g.* “Gradsky” waivers in California)

#### IV. ELEMENTS OF ENFORCEABLE PAYMENT GUARANTIES (cont.)

- G. Guarantor Acknowledgement of Representation of Counsel
- H. Express Disclaimer of Reliance on Representations
- I. Recovery of Preferences
- J. Merger Clause
- K. Governing Law Provision
- L. Spousal Consent in Community Property States

# Guaranty Enforcement & Recourse Beyond The Collateral

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# Strategic Guaranty Enforcement Issues – Outline of Discussion Topics

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- I. Recourse Enforcement - Review of Statutory, Contractual and Practical Concerns
  - A. Statutory Limitations on Recourse Under State Law
  - B. De Facto Limitations on Recourse Resulting From the Structure of the Deal and/or The Parties
  - C. Contractual Limitations on Recourse
- II. Recourse Against Third Parties - i.e., Guarantors, Investors, Title Companies and Others
- III. Alternatives to Recourse Only Against The Property and a Guarantor

# Basic Enforcement Matters

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- I. Enforcing Guaranties
  - A. Actions On Guaranties Can Be Included In a Foreclosure Action, Pursued Separately Or Pursued After a Foreclosure Sale
    - 1. Beware of Fair Value Limitations on Recovery
    - 2. Beware of One-Action, Anti-Deficiency and Other Guarantor Protections
    - 3. Beware of “True Guarantor” Issues
    - 4. Beware of “Consideration” or “Insolvency” Issues
  - B. Completion Guaranty - Cannot Compel Construction, so May Have to Settle For Money Judgment
    - 1. Liquidated Recovery Approach
  - C. Inclusion of Bad Boy Carve-Outs In Completion or Payment Guaranties

# Enforcement Advantages

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- I. Action Against a Guarantor Can be Pursued Even if the Borrower files for Bankruptcy Protections.
  - A. This can be a powerful tool in working out a bankruptcy restructure agreement and/or other matters in the event of
  - B. Any Guarantor who has received proper consideration - e.g., personal benefit by success of the Company Borrower or even in a “pay for play” Guaranty - is subject to enforcement of its Guaranty.
  
- II. An Enforcement Action Against a Guarantor Can be Pursued For The Full Sum Allowed under the Guaranty Regardless of What Collection Actions Are Being Pursued Against the Borrower.
  - A. If a Borrower is an SPE and insolvent, a Lender can in many states disregard the Borrower and Enforcement a Guaranty of Payment Directly Against the Guarantor.
  - B. While Choice of Law for Guaranties is Important, if you have a properly drafted Guaranty, a Lender Should Have an Expectation of Being Able to Enforce Its Guaranty as Written and as Intended.

# Statutory Enforcement Obstacles

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- I. Anti-Deficiency Rules (e.g., CCP Section 580)
  - A. Restricts Recourse to the Collateral
  - B. Protections for Borrowers Usually Extended to Guarantors
- II. One-Action Rules (CCP Section 726)
  - A. Establishes Method of Pursuing Recourse When a Debt is Secured by Real Property
  - B. May Obtain Waivers of 580 and 726 Protections to Pursue Other Remedies or Other Collateral
  - C. Exceptions - Environmentally Impaired Property, Letters of Credit and Other Collateral
- III. Statutory and Common Law Issues, e.g., Community Property Issues



# Considerations Regarding Enforcement When Statutory Matters Apply – Anti-Deficiency

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- A. Key Principal** - Borrower Statutory Protections Extend to Guarantors; However, Whereas Borrowers Cannot Waive Such Protections, Guarantors Can Waive These Matters.
- B.** Anti-Deficiency Protections When a Non-Judicial Foreclosure is Chosen as the Sole Remedy. Western States tend to have such protections, such as CA, AL, AZ, CT, HW, IA, MN, MT, NV, NM, NC, ND, OR, WA, and WI
- 1) Be Careful to Review the Specifics Applicable in each State because the They Differ From State to State, Both in How They Are Applied and What Waivers are Required.
  - 2) For Example, AZ Law Regarding Anti-Deficiency Only For Single Family Homes on at Least 2.5 Acres; However, in CA this Protection Extends to Both SFRs and Commercial Properties.
  - 3) Please See Attachment or Basic Waiver Language.

# Considerations Regarding Enforcement When Statutory Matters Apply – One-Action Rule

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- A. **Key Principal** - Again, Borrower Statutory Protections Extend to Guarantors; However, Whereas Borrowers Cannot Waive Such Protections, Guarantors Can Waive These Matters.
- B. One-Action Protections Applies When a Non-Judicial Foreclosure is Chosen as the Sole Remedy, the Borrower Cannot Be Pursued for any Deficiency Between the Debt Amount and the Appraised Value of the Property.
  - 1) Be Careful to Review the Specifics Applicable in each State because the They Differ for each State, Both in How They Are Applied and What Waivers are Required.
  - 2) For Example, AZ Law Regarding Anti-Deficiency Only For Single Family Homes on at Least 2.5 Acres; However, in CA this Protection Extends to Both SFRs and Commercial Properties.
  - 3) Both CA and UT Have the Most Harsh Statutory Provisions, Whereas OR, WA, NV and ID have “Softer Versions” of this Rule. See example of a Standard Waiver in the Attachment.

# Key Rule For Waivers of Statutory Borrower/Guarantor Protections

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- A. **Key Principal** - Be as Specific as Possible, Both in Describing the Consequence of the Waivers and in Specifically Referring to Statutes Which are the Subject of the Waivers.
- B. Many States Have Adopted Specific Statutory “Safe Harbor” Waiver Language.
  - 1) Suggested Tip - If the State Has Specific Waiver Language, Include Both the Statutory Language, as well as the Descriptive Provisions for the Consequences of all Waivers.
    - 1) The Form Language provided in the Attachment Shows how these two Waivers are Balanced to Cover All Bases.
  - 2) If the Required Waivers are not Included in the Original Guaranty, you can add them in a Forbearance Agreement, a Guarantor’s Approval of any Modification Agreement, etc.

# Community Property For the Enforcement Against All Assets of the Guarantor

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B. Common Law States Tend to be Western States Which Have Spanish Roots.

1) The Following States are Common Law States - LA, AZ, CA, TX, WA, ID NV, NV, and WI.

d) How to Deal with Enforcing a Guaranty Where a Non-Active Business Spouse is not part of the deal, but the Lender wants to recover any deficiency or pay-off of the defaulted loan against the personal and community assets (including revocable trust assets). The following is a Triage for enforcement:

d) **First**, check statutes for enforcement. For example, in AZ, both spouses must sign the guaranty. In OR, a Lender must bring an action against the guarantor(s) within 20 days after initiating foreclosure proceedings against the Borrower.

e) **Second**, if a trust's assets are part of the underwriting for the guaranty, you must name the trust as a guarantor party. So always ask at the inception of a deal if the guarantor includes in its financial statements.

f) **Third**, if the non-active business does not want to be a direct party to the guaranty, have such spouse execute a spousal consent. A template form is attached hereto in the other materials.

# Contractual Considerations to Enforce Guaranties

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- B. Contractual Limitations May Include Limiting Multiple Guarantors to a Pro Rata Liability Based on Their Ownership Interests (As Opposed to the Typical Joint and Several Provisions); an Interest and Carry Costs and/or LTV Maintenance Guaranty; Bad-Boy Carve-Outs; a Cap on Liability; a Requirement that the Guarantor(s) are Liable only after all Collection Efforts Have Been Pursued Against the Borrower; Sliding or Springing Guaranties, etc.
- 2) Obviously, the key to enforcing a non-traditional guaranty is to have direct and clear language in the guaranty, but also language that you can easily explain to a court.
  - 3) Generally, courts are not eager to enforce guaranties; however, all of the cases and bankruptcy matters that occurred during the “Great Recession,” courts have looked more favorably as to the enforcement of guaranties as long as they understand the language and reasoning for the guaranty. (see 172 Madison (NY) LLC v. NMP-Group, LLC, N.Y. Co. Index No. 650087/2010; and, Steven Weinreb v. Fannie Mae, 993 N.E.2d 223 (And. App. 2013).

# Consideration of The Meaning of Waste, Failure to Pay Taxes of Insurance Premiums

- B. The definition of “Waste” can include both actual damage to the collateral, as well as damages arising in another context, such as failing to pay rent on leased property which would be a liability of the Lender following a foreclosure.
  - 2) For this reason, more guarantors want to limit waste to only “physical waste.” This clearly is a business issue, but one that you need to keep in mind when preparing an action against a guarantor to recover waste damages.
- C. Failing to pay key property costs, such as taxes and insurance premiums.
  - B. Using common bad-boy language, a guarantor could be liable for any and all taxes and insurance payments, regardless of the performance of the underlying business.
  - C. Accordingly, Guarantors have been seeking a limitation on liabilities to include only a failure to make such payments if the property is generating cash flow which is not applied to these matters. This commonly is referred to as a “Non-Recourse Guaranty.”

# Practical Considerations For Guaranty Enforcement

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- B. Upstream Guarantors, Downstream Guarantors, Cross-Stream Guarantors, Related Family Member Guarantors, Pay-for-Play Guarantors, etc.
  - 2) Upstream Guaranty - A Subsidiary Company Guarantees Payment/Performance of its Parent Company's Debt. Enforcement Turns Almost Wholly on Whether Lender Can Show Consideration and Solvency for a Subsidiary Company to Execute Such a Guaranty.
    - e) The issues of consideration and solvency should not be assumed for any Upstream Guarantor.
    - f) Consideration should be spelled out specifically, more so than in an ordinary guaranty. Such consideration may include indirect benefits such as goodwill, strength of parent company's support of the Subsidiary Guarantor, etc.
    - g) Moreover, the Subsidiary Guarantor must have been solvent when the Guaranty is signed, and solvency should be tested under bankruptcy law requirements.
    - h) Key current case law is

# Guaranty Enforcement (Downstream vs. Cross-Stream Guaranties)

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- B. Downstream Guaranty - A Parent Company or Owner Guarantees Payment/Performance of its Subsidiary Borrower's Debt. Most Common Form of Guaranty and Generally Enforceable, But Never Ignore the Consideration and Insolvency issues to avoid Fraudulent Conveyance Issues.
  - C. Cross-Stream Guaranty - A Subsidiary Company Guarantees Payment/Performance of a Related Subsidiary Company's Debt. Just as with Upstream Guaranties, Enforcement Turns Almost Wholly on Whether Lender Can Show Consideration and Solvency for a Subsidiary Company to Execute Such a Guaranty.
    - e) Consideration should be spelled out specifically, more so than in an ordinary guaranty. Such consideration may include indirect benefits such as goodwill, strength of parent company's support of the Subsidiary Guarantor, etc.
    - f) Moreover, the Subsidiary Guarantor must have been solvent when the Guaranty is signed, and solvency should be tested under bankruptcy law requirements.
  - D. I Use a "Contact Chart" to Determine Upfront the Direct and/or Indirect Connection Between Guarantor and Borrower. See attachment for an example.



# Alternatives to Guaranties

## I. Funding or Equity Agreements

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- A. Used with Equity Investors and Similar Parties Who, For Various Business Reasons, Cannot Execute a Guaranty
- B. Direct Obligation vs. Surety Obligations
- C. Used With or Without a Separate Note

## II. Third Party Accommodator Pledge of Assets

- A. Usually Subject to Recourse Limitations
- B. Guarantor Waivers May Apply
- C. Consideration is always an Issue

## III. Cash Management; Reserves

- A. Springing Lockbox or Soft Lockbox
- B. Changes In Waterfall Provisions
- C. Application of Reserve or Other Excess Funds

# Final Thoughts

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- C. If a Loan Default is Imminent or has Occurred, Immediately Review Guaranties to Spot Any Issues
  - 1. If Document Deficiencies exist, they can be corrected within a forbearance, conditional settlement or loan modification agreement
    - a) There are times that executing such interim measures help both the borrower, but can also clean up the guaranty documents.
  - 2. Always Attend to Consideration and Solvency Representations
    - a) This is a good practice for any guaranty, but becomes an important issue for the enforcement of upstream, cross-stream and/or pay-for-play guaranties
  - 3. Remember that Enforcement of a Guaranty Should Be Included as Part of an Integrated Recovery Plan Against the Borrower, Any Pledged Collateral and Each Guarantor