Wednesday, November 3, 2021
3:30 PM - 4:45 PM

Workshop 3

TOMATO, TOMAHTO, GUARANTY, GUARANTEE: LET'S CALL THE WHOLE THING OFF AND SUE THE GUARANTOR

Presented to

2021 U.S. Law Conference
San Francisco Marriott Marquis
San Francisco, CA
November 3-5, 2021

by:

David Freedman
Partner
Alston & Bird LLP
90 Park Avenue
New York, NY 10016
David.Freedman@alston.com

Peter Oxman
Partner
Seyfarth Shaw LLP
700 Milam St, Suite 1400
Houston, TX 77002-2797
poxman@seyfarth.com

***The authors would like to acknowledge the contribution made by Paul LeBlanc (Seyfarth Shaw LLP) and Anthony Gingerelli (Alston & Bird LLP) in preparation of these materials.

1. Introduction.

The California Civil Code defines a surety or guarantor as "one who promises to answer for the debt, default, or miscarriage of another, or hypothecates property as security therefore." Cal Civ. Code § 2787.

In the King James version of the Bible, King Solomon himself warns against guaranties in Proverbs 11:15: "He that is surety for a stranger shall smart for it: and he that hateth suretyship is sure."

Despite King Solomon's warnings, guaranties have been used to backstop obligations of individuals and companies for hundreds of years and in many different contexts, including commercial real estate transactions.

The truth and significance of Solomon's admonition has been seen in every major economic downturn in the U.S. economy during the 20th Century and, to a certain extent, during the COVID-19 pandemic. Many individuals and companies gave guaranties to creditors for the benefit of business associates or friends when times were good, but later suffered significant consequences when debtors defaulted and the guaranties were called.

Although guaranty agreements are used in many different types of transactions, this paper will focus on two specific types of guaranty agreements: (1) Lease guaranties given to secure the tenant's payment performance under its retail lease, and (2) guaranties given to secure payment and performance under mortgage loans.

We note at the outset that state laws differ, sometimes significantly, with respect to the enforceability of guaranties. Whole treatises have been written on the topic. *See, generally*, Jeremy S. Friedbert, et. al, *The Law of Guaranties: a Jurisdiction by Jurisdiction Guide to U.S. and Canadian Law*, ABA Business Law Section, 2013. Such differences are beyond the scope of this paper.

Much of the literature regarding guaranty agreements focuses on drafting considerations and enforcement. *See, generally*, Joshua Stein, *Model Lease Guaranty*, The Practical Lawyer, May 2016, p. 29; Stephen Peterson, et. al, *Enforcing Commercial Loan Guaranties*, Georgia Bar Journal, October 2009, p. 12; and Stephen Richman, *Watch Your Language with Commercial Lease Guaranties*, The Ohio Real Estate Law Blog (2014),

http://www.ohiorelaw.com/2014/12/watch-your-language-with-commercial.html (last visited June 9, 2021). We have drawn from these sources as well as others in preparing this presentation.

2. **The Golden Rule of Guaranties.**

The single most important thing to remember about guaranties is that a guaranty is only as good as the party giving the guaranty. This point is made in a funny, albeit confusing way by the late comedian Chris Farley, in Paramount Pictures' 1995 film, *Tommy Boy*. Farley's character, Tommy Callahan, desperately tries to win over a customer, Ted Nelson, who initially refuses to buy brake pads from Callahan because his product does not come with a guaranty on the box:

Tommy: Let's think about this for a sec, Ted, why would somebody put a guarantee on a box?

Ted Nelson: Go on, I'm listening.

Tommy: Here's the way I see it, Ted. Guy puts a fancy guarantee on a box 'cause he wants you to feel all warm and toasty inside.

Ted Nelson: Yeah, makes a man feel good.

Tommy: 'Course it does. Why shouldn't it? Ya figure you put that little box under your pillow at night, the Guarantee Fairy might come by and leave a quarter, am I right, Ted?

Ted Nelson: What's your point?

Tommy: The point is, how do you know the fairy isn't a crazy glue sniffer? "Building model airplanes" says the little fairy, well, we're not buying it. He sneaks into your house once, that's all it takes. The next thing you know, there's money missing off the dresser and your daughter's knocked up, I seen it a hundred times.

Ted Nelson: But why do they put a guarantee on the box?

Tommy: Because they know all they sold ya was a guaranteed piece of s#*t. That's all it is, isn't it? Hey, if you want me to take a dump in a box and mark it guaranteed, I will. I got spare time. But for now, for your customer's sake, for your daughter's sake, ya might wanna think about buying a quality product from me.

Ted Nelson: Okay, I'll buy from you.

Tommy: Well, that's... What?

Unfortunately, legal negotiations, particularly those related to guaranty agreements, rarely go as smoothly or with such humor (intended or not).

3. Guaranty Basics.

A. Why are Guaranties Required. The competing interests of the landlord/lender and the tenant/borrower are usually very clear. The lender/landlord wants to ensure full repayment or performance and the borrower/tenant wants to close the deal, but at the same time seeks to limit its liability wherever possible. Landlords and lenders each run credit checks on their tenants/borrowers. Lenders also require additional collateral, such as real estate. Yet in many cases, they want another creditworthy party to be liable for the obligations, preferably a "live body."

One reason for the use of a guaranty is the limited liability protection that corporations, limited liability companies and limited partnerships provide to their stockholders, members and limited partners. Sophisticated approaches have been devised to limit and compartmentalize exposure to liabilities. One example is the use of multiple affiliated companies to hold assets, including leasehold interests. Some retailers, for example, create a special purpose entity for every leasehold, others create smaller bundles. Unless the ultimate parent or large U.S.-based subsidiary is on the lease or is a borrower under the loan, the landlord or lender will request credit support from a parent company and/or from the individual owners or principals.

Bankruptcy considerations are also a key reason to require a guaranty. Insolvency laws permit debtors to avoid their obligations, leaving creditors with little or no chance of collecting on their debts. Properly drafted guaranty agreements will continue in effect even if the borrower or tenant files for bankruptcy protection.

One of the most important reasons why landlords/lenders require a guaranty is to disincentivize various behaviors. In certain circumstances (i.e. a typical lease guaranty or a payment guaranty on a loan), the guaranty serves as a hammer in the case of a default. For example, an individual guarantying payment of a lease for the benefit of her company is more likely to find a way to avoid default, since the consequence of doing so hits them in their own wallet. In other circumstances (i.e. non-recourse lending transactions where the creditor is not relying on the "credit" of the sponsor per se, but rather the value of the collateral), a guaranty may be utilized to disincentivize certain enumerated bad acts.

B. Guaranty Versus Direct Obligation. A threshold question is whether a guaranty is needed at all. Why not just have the guarantor sign the lease or loan documents and become obligated directly to the lender or landlord. *See, generally* Stein, *Model Lease Guaranty* at page 38. Put simply, a separate guaranty from a different party not only provides the landlord or lender a separate source of repayment, but it also provides an opportunity to override many of the defenses that have been used by borrowers/tenants to avoid their obligations. The existence of a personal or corporate parent guaranty serves as a powerful disincentive to a tenant/borrower who might try to escape payment of their obligations. Nowhere is this more clear than the "springing full recourse guaranty" used in mortgage loan transactions that converts a non-recourse loan to a full recourse loan in the event the borrower seeks protection under bankruptcy laws.

Other reasons for a landlord/lender to require a guaranty may include ease of enforcement. A properly drafted guaranty containing appropriate waiver language can streamline the enforcement process and remove complicated issues of fact that a tenant or borrower may have under the terms of a lease or loan. In addition, if the tenant/borrower is a foreign (non-U.S. domiciled) entity, a landlord or lender may find it easier to enforce a guaranty in a foreign court than a lengthy lease or loan document because the guaranty is a simple contract while a lease might be found to be enforceable only in the jurisdiction where the underlying property is located. Further, in lending transactions it is common for the lender to require that the borrowing entity be a "special purpose entity" that is designed in a manner to minimize contingent liability and bankruptcy risk.

Tenants may also prefer to use a guaranty rather than become a direct party to a lease. A party to a lease faces direct exposure to third party claims from visitors, service providers, and others. A lease guarantor's obligation is only to the landlord and not to tenants or customers of the business or other third parties. A foreign company might also prefer to guaranty an obligation rather than become a direct party if it is trying to avoid "doing business" in the U.S. and thereby becoming subject to U.S. laws. A party to a lease is more likely to be deemed to be "doing business" than a party that simply executes a guaranty.

C. Strict Construction Against the Beneficiary. As a general matter, courts tend to strictly construe guaranty agreements against the benefitted landlord/lender. As Joshua Stein writes:

> "Courts often seem to believe that any Guarantor is "a fool with a pen" who needs the courts protection. In commercial transactions, that theory usually holds no water. Still, judges seem to have gone out of their way to invalidate or limit guaranties, particularly in California, less so in New York, with other states all over the lot."

Stein, *Model Lease Guaranty*, at 30. Guaranty agreements that were once a single sentence or paragraph now customarily stretch to over 10 pages. The modern guaranty is replete with provisions that purport to avoid, waive or otherwise neuter the impact of laws and court decisions favorable to the debtor in order to better ensure payment and/or performance.

4. Fundamentals of a Guaranty.

A. Substance over Form. There are no "magic words" required to establish a guaranty; rather, it is the substance of the transaction that determines where an instrument constitutes a guaranty. A document entitled "Guaranty" may not necessarily create a meaningful obligation whereas a promise may qualify as a guaranty regardless of whether it is labeled as one.

B. Contract Law. Guaranty agreements are independent obligations that stand apart from the underlying loan or lease contracts. Some states are more "business oriented" and provide favorable treatment of lenders and creditors, while other states have significant limitations on enforcement. Lease obligations are governed by the law of the state in which the property is located. However, landlords and lenders will typically want to have a

guaranty governed by the laws of a state that gives them favorable treatment, such as Delaware or New York. The courts in most states will strictly construe a guaranty agreement against the creditor, limiting enforcement to the specific terms of the document. This is particularly true when dealing with individual borrowers and tenants as opposed to large scale commercial transactions between sophisticated parties.

C. Types of Guaranty.

(i) *Full vs. Partial Guaranty*. A full guaranty covers the entirety of the obligations of the tenant/borrower, including future indebtedness. A partial guaranty, as the name implies, covers less than all of the obligations. Limitations on the liability of a guarantor take many forms. Some guaranties include a "cap" or liability ceiling on the guarantor's liability, such as a limit to a certain dollar amount or a certain percentage of the debt. Other guaranties include a "burn off" provision whereby the amount of the guaranty decreases or goes away entirely once certain milestones are satisfied.

(ii) *General vs. Specific.* A general guaranty covers all of the obligations in the underlying loan contract or lease. Most lease guaranties are general in nature. However, many loan guaranties cover only a limited set of obligations. For example, a completion guaranty typically covers only the initial construction and completion of a building or certain improvements in a building and the payment of all costs related to that construction.

D. Essential Provisions.

(i) *Consideration*. While every contract needs to be supported by consideration, and it is important for a guaranty to state the consideration, the benefits to the guarantor from the transaction are generally sufficient to support the obligation. This issue is discussed in the context of enforcement as well.

(ii) *Description of Guaranteed Obligations*. The guaranty must clearly describe the obligations being guaranteed and include all present and future obligations under the lease or loan documents, as applicable. Almost all guaranties include in the definition of guaranteed obligations all costs of enforcement and all damages incurred as a result of a breach of the underlying contract.

(iii) *Guaranty of Payment and Performance, Not Collection*. Most guaranties state that that it is a guaranty of payment and performance and not of collection. The reference to "performance" is sometimes removed if not applicable to a transaction. One scenario where the deletion of references to performance may be appropriate would be a loan guaranty that requires the guarantor to guaranty the payment of the cost to complete improvements, but that does not require the guarantor to actually perform the work. As Joshua Stein notes, the lender may not care about performance, just payment. Stein, *Model Lease Guaranty* at p.44. In addition, a guaranty of performance raises issues about access. For example, how can the guarantor be expected to perform if it cannot enter the property because the lender or landlord has taken possession. *Id*. Nevertheless, most lease and loan guaranties include references to performance.

[**Practice Note**: Many completion guaranties given in construction loan transactions require that if the lender so demands following a default by the borrower, the guarantor will step in and finish construction. The hesitancy of courts to specifically enforce this obligation is discussed below. An issue that is often negotiated is whether the lender will be required to fund remaining draws on the loan if, following a default by the borrower, the guarantor is required to step in and finish the work. Standard form loan documents often require this performance without an obligation to fund further draws once the borrower defaults. From the borrower's perspective, this provides a windfall for the lender - the lender may foreclose, require the guarantor to complete construction at its expense and never fund the remainder of the loan. Borrower's counsel frequently negotiate provisions requiring the lender to fund draws so long as the guarantor cures monetary and other defaults that it is capable of curing, such as bonding around mechanics' liens, but not those that the guarantor is incapable of curing.]

(iv) *Absolute, Unconditional and Irrevocable*. Most guaranties contain these buzzwords, which are intended to drive home the fact that the guarantor is truly "on the hook" for the underlying obligations in all instances.

(v) *Primary Obligor*. Another phrase almost always seen in guaranties is that the guarantor signs "as a primary obligor and not merely as surety." This is intended to differentiate a guaranty from other forms of credit support and specifically permit the landlord/lender to enforce the guaranty without first having to pursue remedies against the tenant/borrower. In some jurisdictions, there is little difference between a guaranty and surety and the terms of often used interchangeably.

(vi) *Waiver of Suretyship Defenses; No Discharge/Impairment*. Whether established by statute or common law, these are defenses arising out of action (or inaction) by the landlord/lender without notice to, or the consent of, the guarantor. The list of suretyship defenses may vary by jurisdiction. Applicable state law may also permit a general "waiver of all suretyship defenses" without requiring them to be specifically enumerated.

Among these suretyship defenses are:

(a) That the landlord/lender first pursue its remedies against the tenant/borrower and/or the security provided (if any) before pursuing claims against the guarantor.

(b) Alteration of the obligations without notice to or consent of the guarantor.

(c) Actions by the landlord/lender that prejudice guarantor's rights and remedies against the tenant/borrower.

(d) The illegality, invalidity or enforcement of any obligation or the underlying loan or lease documents, as applicable. If the underlying documents are determined to be unenforceable against the tenant/borrower, the guaranty requires that as between the landlord/lender and the guarantor, the documents or provisions be treated as if they were enforceable.

(e) Changes in the time, manner or place for payment under the documents or any rescission, waiver, release, assignment, amendment or other modification to the lease or loan documents, as applicable.

(f) Any substitution or release, amendment, waiver, modification, or non-perfection of any collateral or any other guaranty.

(g) Any failure or default by the landlord/lender under the terms of the lease or loan.

(h) Failure to disclose to the landlord or lender, as applicable, any changes to the organizational structure or the business of the tenant or borrower.

(i) Failure of any other guarantor or third party to execute and deliver the guaranty agreement or the release or reduction in liability of any other guarantor with respect to the same obligations.

(j) Failure of the landlord/lender to assert claims or demands or to exercise any right or remedy it may have.

(k) Any other circumstance, acts, omission or manner of administering the underlying lease or loan documents or the existence or reliance on any representation that might vary the risk or otherwise provide a defense or result in a legal discharge of the borrower from the guaranteed obligations.

[**Practice Note:** Notwithstanding these terms, most landlords and lenders require the guarantor to execute a joinder to any amendment or modification of the lease or loan documents to confirm that the guaranty remains in full force and effect and applies to the agreements as amended.]

(vii) *Continuing Obligation.* The guarantor is generally required to confirm that the guaranty is continuing in nature and applies regardless of changes to the underlying agreements or whether the other debtors or guarantors remain in place. Guaranty documents often include repetitive provisions that seek to negate arguments a guarantor may make in an effort to avoid liability. As a result, a single guaranty may include an agreement regarding the continuing nature of the guaranty, a representation and warranty, and a waiver designed to close off any gaps that could provide a guarantor a way to avoid liability.

(viii) *Survival; Termination*. A typical full guaranty will provide that it is continuing in nature and applies to all presently existing and future obligations until the "complete, irrevocable and indefeasible, payment and satisfaction in full of the Guaranteed Obligations." Guaranty agreements with "burn off" provisions may reduce the guarantor's liability from full liability to a capped amount over time or simply terminate as long as the borrower has performed and/or achieved certain performance targets (e.g., completion of improvements, achieving full occupancy or generating sales at a certain level or meeting financial metrics for a sustained period of time).

[**Practice Note**: Tenants and borrowers usually negotiate provisions in their leases and loan documents to permit the tenant/borrower to execute an exit strategy - typically the sale of the business or project. If the transaction involves a guaranty on behalf of a party, the transfer/assignment provisions should specifically address the replacement of the original guarantor with a new guarantor acceptable to the landlord/lender or meeting certain established criteria. In such cases, it is important to be clear that the guarantor being replaced remain liable for latent matters (i.e. losses or liability that may arise out of events that occurred prior to the applicable transfer). Where no right to replace the guarantor exists, the parties may agree for the transferor to remain obligated under a guaranty and for the transferee to indemnify the guarantor against any liabilities and costs incurred under the guaranty following the date of the assignment. Remember, though, that the same golden rule applies to indemnity agreements - the indemnity is only as good as the party giving the indemnity.]

(ix) *Recovered Payments*. This refers to a payment that the landlord or lender has received from the tenant or borrower or guarantor, as applicable, but is required to be returned or "disgorged" for any reason, including a determination that such amounts constitute a preference or fraudulent transfer under bankruptcy laws. Under these provisions, the holder of the guaranty requires that amounts so disgorged be repaid by the guarantor. This should include interest until repaid and all related legal expenses. Other provisions related to this issue generally provide that if disgorgement is required, then the guarantor's obligations shall apply as if such disgorged payment had never been made. It is also important for the guarantor's obligation to pay a recovered payment to survive if such disgorgement is required after the termination of the lease or repayment of the loan.

(x) *Additional Waivers*.

(a) Guaranty documents may also contain express waivers of contract defenses, such as statutes of limitations. State law varies as to whether statutes of limitations may be waived. For example, Texas courts have blurred a once bright line public policy against waivers of statutes of limitations, holding that although "[b]lanket pre-dispute waivers of all statutes of limitation are unenforceable, waivers of a particular limitations period for a defined and reasonable amount of time may be enforced." *Godoy v. Wells Fargo Bank, N.A.*, 575 S.W.3d 531 (Tex. 2019). This reflects a general policy of allowing sophisticated parties to freely and knowingly enter into contracts.

(b) Other waivers commonly seen in guaranty agreements include waivers of notices, jury trials and offset rights. Guarantors are often asked to waive any counterclaims and defenses, diligence, and notices, including any lack of notice, including notice of acceptance, accrual, creation, dishonor, extension, modification, nonpayment, protest or renewal of any guarantied obligation.

[Practice Note: While landlords/lenders may request absolute waivers, most tenants/borrowers try to preserve mandatory counterclaims as well as the defense of payment and performance.]

(xi) *Representations and Warranties*. As in many other contracts, landlords/tenants want to avoid arguments by guarantors that representations and warranties were made during negotiations or after closing that contradict the terms of the document, or that the guarantor "didn't understand what she was signing" or was not told of the obligation. The use of representations and warranties helps the landlord/lender establish facts that can be used to defend against such arguments. As a result, it is common to include representations and warranties by the guarantor that the landlord/lender has made no statements, promises, representations or warranties except as expressly provided in the guaranty and for the guarantor to affirmatively waive any claim to the contrary. Other creditor-protective representations and warranties include statements that the guarantor has read the guaranty document, understands its terms and had the opportunity to review the guaranty with an attorney of her own choosing.

(xii) *Governing Law*. Often lenders and even landlords will provide that the law of a state other than the one where the real property is located governs the guaranty. Usually this represents an effort by the lender to permit adjudication of claims under a guaranty in a court that is more favorable to the landlord/lender, such as Delaware and New York as opposed to California. This is another feature of a guaranty that differs from a lease or a security instrument. A lease is always going to be governed by the law of the state where the property is located. A guaranty, however, gives the creditor the ability to select a state whose laws are more favorable to lenders, as long as there is a reasonable nexus between the selected state law and the parties or transaction.

(xiii) *Acknowledgment; Apostille*. Finally, even though the guaranty is almost never recorded in the public records, many landlords/lenders require that the guaranty agreement be notarized or, if signed outside of the U.S., that an apostille be attached to the document to verify that the person signing is who she says she is. This makes it far easier for a landlord/lender to prove up a document in court and avoid arguments such as "that is not my signature" or "that is not the same document I signed."

(xiv) *Authority; Due Execution and Delivery, and Enforceability*. Although not very common in lease transactions, most commercial real estate lenders require the borrower's counsel to deliver a legal opinion covering, among other matters: power and authority, due execution and delivery, and enforceability. Even where no legal opinion is required, the guaranty itself will typically include representations and warranties from the guarantor as to these matters.

(xv) *Estoppels*. Increasingly, guaranty agreements require the guarantor to provide estoppels to the landlord/lender to confirm that the guaranty remains in full force and effect and that the guarantor is not in default and has no claims against the landlord/lender. The obligation may also be included in the lease or loan documents to require a guarantor estoppel. Although the logic for requiring a guarantor estoppel is obvious, many guaranty agreements do not include this requirement. If no such obligation is included in the guaranty itself or in the lease or loan documents, then it is very difficult to require an estoppel from a guarantor who is not expressly required to deliver one.

[**Practice Note**: It has become commonplace for lenders to require borrowers to execute and deliver separate signature pages detached from the underlying loan documents and for those pages to then be attached to the final document by an attorney for the lender or by a title company. While this practice may make closings more convenient and efficient, this practice may lead to the very arguments that landlord/lenders try to avoid with respect to representations and warranties and notarization - that the signatory did not know what she was signing and should not be held to the obligation. While courts generally uphold documents knowingly signed by sophisticated parties, the greater risk may be to the signatory's counsel. As legal documents have expanded in size and complexity over the years, fewer clients are actually reading them and rely completely on their lawyers to review and comment; they sign signature pages without the documents attached and dutifully return them to the lender's counsel. This creates risk for the lawyer that the guarantor will claim that the lawyer did not fully explain the risk to a guarantor. From the perspective of a client, however, it is important to read and understand the terms of guaranty agreements before signing them.]

5. General Considerations in Enforcing Guarantees.

A. Establishing Consideration.

The basic structure of a guaranteed obligation in a commercial leasing or lending transaction implicitly brings into question whether adequate consideration exists. The guarantor is typically not the direct beneficiary of the transaction (i.e. the guarantor doesn't receive loan proceeds in a lending transaction and is not granted a leasehold estate in a leasing transaction). Courts have, however, long held that a lender's extension of credit to the primary obligor provides enough consideration for a guaranty signed at the same time. See *Jenista v. Burlington N*., 388 N.W.2d 770, 773 (Minn. Ct. App. 1986) (guaranty supported by consideration because lender suffered detriment by extending credit to debtor). In circumstances where a guaranty is executed without an extension of credit (i.e. a guaranty delivered when forbearing from exercising remedies in connection with a loan workout) — the "failure of consideration" defense may be more prescient. It is essential that the recitals to any guaranty should contain an acknowledgment by all parties that adequate consideration has been granted and should include a description of the consideration (i.e., "Guarantor executes and delivers this Guaranty in consideration of, and to induce, Lender's extension of credit to Borrower. Guarantor acknowledges that Lender would not have extended such credit but for this Guaranty.").

B. Enforcing Payment vs. Performance.

As described throughout this paper, creditors and landlords generally obtain either a payment guaranty, a completion/performance guaranty or some combination thereof. Performance guarantees are helpful to ensure that an obligor does not walk away from an obligation. Payment guarantees are better utilized as credit enhancements. Courts have been reticent to require the guarantor on a completion guarantee to "specifically perform" completion of a project. See *Black v. O'Haver*, 567 F.2d 361 (10th Cir. 1977) (lender was granted the cost of completion of the project rather than specific performance even though the guarantor executed a completion guarantee). Further, a lender/landlord may also be reluctant to keep a developer/tenant involved in a project when the lender/landlord is in the process of trying to dispossess the applicable party of their interest (i.e. through foreclosure or eviction). In dealing with a completion/performance guaranty, the creditor is far more likely (and probably better off) to rely on a liquidated damages clause to seek the cost of completion of a project. It can be time consuming to establish appropriate damages (which may involve competing appraisals and other diligence) and the parties may negotiate various credits to be applied against damages (i.e. unadvanced funds on a construction loan).

C. Establishing "Bad Acts".

An essential feature in non-recourse lending is the "bad act" guaranty, also referred to as a "bad boy" guaranty and as a "non-recourse carve-out" guaranty. This issue is generally not applicable to lease guaranties. In circumstances where the creditor is relying on the property level cash flow and no "warm body" is on the hook to guaranty the debt, "bad act" guarantees are utilized to ensure the creditor has a hammer against a deep pocket in situations where the developer interferes with the asset and/or the creditor's remedies. It should be noted that not all of the actions or circumstances triggering guarantor liability constitute "bad acts" within the control of the borrower or guarantor. For example, a "bad act" guaranty will often include failure by the borrower to pay taxes or insurance on a property. In some circumstances, the parties may negotiate that liability for the foregoing obligations will only arise in the event the property has generated sufficient cash flow and the borrower failed to utilize the cash flow to pay its obligations. If, however, the parties do not negotiate any such "cash flow qualifier", the guarantor's liability is not tied to any "bad act" and the guaranty is simply an allocation of risk.

These guarantees can also be utilized to provide credit enhancements with respect to property level defects that are discovered during diligence (i.e. the "bad act" guarantor may indemnify the lender for losses incurred in connection with a title defect that is discovered). The "bad act" guaranty typically has two buckets of enumerated protections.

The first bucket includes items for which the lender can call the entire outstanding debt against the guarantor on a personal/recourse basis. Typical items in this "full recourse" bucket include the filing of a voluntary or collusive involuntary bankruptcy action, breach of the loan document level transfer provisions, and/or breach of single purpose entity covenants. These "full recourse" triggers are a relatively new feature developed over the last 30 years to disincentivize borrowers from seeking the protection of insolvency laws.

The second bucket of enumerated items includes items with respect to which the guarantor is indemnifying the lender for any losses incurred. Typical "loss carveouts" might include misrepresentation, misappropriation of funds, failure to pay taxes or insurance premiums, etc. These guarantees largely have the prophylactic effect desired by creditors. In 2010, in the *Extended Stay of America* Chapter 11 bankruptcy proceeding, guarantor David Lichtenstein was held jointly and severally liable with his company, Lightstone Capital, for a $100 million guarantee following the company's bankruptcy filing. In enforcing a "bad act" guaranty, the creditor will need to establish that the enumerated bad act has occurred and, in the case of "loss carveouts" will need to establish the extent of the loss (which, much like the case of liquidated damages in a completion guaranty, can be contentious and time consuming). Guarantors may try and defend actions where an unrelated third party caused the loss. In these instances, clarity of language (which is construed against the creditor) and appropriate consideration (as discussed above) is of utmost significance.

D. One-Action Rule.

While there are too many state laws that impact guaranty enforcement to explore in a workshop of this nature, there is one genre of statutes that is worth mentioning. Certain states (such as California and New York) have "one-action" rules. A one-action rule often requires a lender to exercise foreclosure remedies before it can obtain a deficiency judgment against the borrower or take other action against a borrower's assets (these other actions may, in certain circumstances, include enforcement of a guaranteed obligation). From a practice perspective it is important to keep in mind whether the applicable state has a one-action rule and include (as referenced above) appropriate waivers.

By way of example, under the one-action rule in California, the legal relationship of the guarantor and the borrower may determine the enforceability of a guaranty given the one-action rule limitations. Obtaining a guaranty from a party related or closely tied to the borrower may create defenses. See, e.g., *Union Bank v. Dorn*, 254 Cal. App. 2d 157 (1967) (after nonjudicial foreclosure, lender barred from seeking recovery from guarantors who were principal obligors under a different name). To the extent appropriate waivers are contained in the guaranty, the California one-action rule and security-first rules do not bar a creditor from seeking recovery against a guarantor prior to foreclosing on the real property or from including a guarantor in an action against a debtor or the security. See *Security First National Bank v. Chapman*, 31 Cal. App. 2d 182, 186 (1939); *Loeb v. Christie*, 6 Cal. 2d 416, 419 (1936). In *Black Sky Capital, LLC v. Cobb*, 7 Cal. 5th 156 (2019). Per California law, these waivers can be effective as to legal and statutory defenses expressly set out in the guaranty, but said waivers may not release all defenses, such as equitable defenses. See Cal. Civ. Code § 2856; *Union Bank v. Gradsky*, 265 Cal. App. 2d 40 (1968); *Bank of America v. Stonehaven Manor*, LLC, 186 Cal. App. 4th 719 (2010); *California Bank & Trust v. DelPonti*, 232 Cal. App. 4th 162 (2014). When enforcing a guaranty in California, it is important to utilize local counsel review to ensure that appropriate waivers are in place.

6. **Foreign Guaranties**.

In instances where a guarantor is domiciled in a foreign jurisdiction, unique challenges are presented. In the circumstance where the foreign guarantor has assets in the United States, it's simply a matter of complying with local procedures regarding jurisdiction. The challenge arises where the applicable guarantor has insufficient assets in the United States to satisfy the obligation and the lender has to enforce a judgment obtained in the United States against the obligor in the foreign jurisdiction.

A. Export Judgment.

Whenever a transaction involves a foreign guarantor, it is good practice to obtain an "export judgment" opinion from licensed attorneys in the foreign jurisdiction. These opinions will generally provide that a judgment obtained in the United States can be enforced in the foreign jurisdiction. The scope of these opinions can vary greatly (i.e. the opinion may be a single sentence stating that a judgment can be exported or it may be a full reasoned opinion). Regardless, in each instance, it is important to understand the steps that need to be taken (and the potential costs and time that may need to be expended) in exporting a judgment when considering a transaction involving a foreign obligor.

While in many instances, treaties will control export of judgment, in others common law principles will control. As an example, in the United Kingdom, the following elements must be satisfied:

(i) The U.S. judgment must be a final and conclusive judgment.

(ii) The judgment to be enforced must be for an ascertainable and definite sum of money.

(iii) The English court must be satisfied that the U.S. court had jurisdiction to hear the claim.

(iv) The U.S. judgment must not have been obtained by fraud.

(v) An English court will not recognize or enforce a U.S. judgment if to do so would be contrary to English public policy or the European Convention on Human Rights.

(vi) A judgment will not be enforced without the debtor having been given sufficient notice of the underlying U.S. proceedings.

The exported judgment will be deemed unenforceable in each of the following instances:

(i) Any other form of order (for example, specific performance of a contract or the taking of an account of profits) is not enforceable at Common Law.

(ii) The English court will not permit, either directly or indirectly, the enforcement of a foreign judgment for the payment of taxes or for any fine or penalty.

(iii) A foreign judgment will not be enforced at Common Law if it was obtained by fraud.

See Dennis Campbell and Dharmendra Popat, *Strategies for Effective Management of Crossborder Recognition and Enforcement of American Money Judgments*, 56 AM. JUR. TRIALS 529, updated May 2021.

B. Gross Up Provisions:

[**Practice Note**: One additional tip when a foreign guarantor is involved: any payment by a foreign guarantor may be subject to a withholding tax in the guarantor's country. It is best practice to include a "gross-up" provision in the guaranty which substantively provides that any payment of the guaranteed obligations must be increased such that, after tax, the creditor will receive the amount it would have received if no taxes had been withheld.]