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Analysis will determine limits of partial guaranties

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Developers and investors were often required to provide personal guaranties in order to obtain acquisition, development or construction loans secured by a mortgage covering the commercial real property - and "partial guaranties" were provided to the lenders in many of these loan transactions.



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As property values continue to decline and commercial loan defaults increase, lenders are instituting litigation against guarantors to collect under these guaranties. Guarantors are discovering that the liability limitations in their partial guar-

anties may not provide the protection that was intended.

Let's review some general principles that apply to most loan guaranties and then discuss certain issues that may arise in partial guaranty situations.



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General principles

Regardless of whether the terms of the guaranty require the guarantor to pay all or a portion of the loan, certain general principles will apply.

■ Defenses of a guarantor are limited and are often waived in the guaranty agreement: Most guaranties prepared by lending institutions contain



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enforceable waivers by the guarantor of various defenses that may be otherwise available to a guarantor under the "common law" of Florida. In addition, lenders will typically require the guarantors to waive any defenses as a condition to engaging in any workout discussion with respect to a defaulted loan.

■ Lender may generally pursue guarantor before foreclosure sale: Unless the loan documents provide otherwise, the guaranty will typically provide that the lender may seek to collect against the guarantor before the lender

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institutes or consummates a judicial foreclosure sale of the collateral for the loan. This type of guaranty is called a "guaranty of payment."

■ Bankruptcy of borrower usually does not stay creditors of the guarantor. When a borrower files for protection under Chapter 11 of the Bankruptcy Code, an "automatic stay" immediately protects all of the "property of the borrower's estate" from the collection activities of any creditor while the borrower formulates a restructuring plan or until the bankruptcy court permits creditor action. However, except in rare circumstances, this automatic stay does not protect the guarantor of the borrower's loan from being sued by the lender.

Partial guaranty issues

■ **Conflicting language problem:** Lenders typically modify their standard guaranty agreement to provide for a limitation of liability for the guarantor. The interplay between the lender's standard guaranty form and the added "limitation of liability" provision may sometimes create ambiguity and uncertainty regarding the meaning of the text.

■ **Interest guaranty:** Partial guaranties will usually include some type of guaranty of interest under the loan. However, how the interest is calculated or when the accrual of interest ceases is sometimes difficult to determine from the terms of the guaranty.

For instance, if a guaranty covers all or a portion of the accrued interest under a loan, does the guaranty continue to cover default interest that accrues after the maturity date with no end date or does the guaranty of interest cease to accrue at the maturity date of the loan? If the guaranty only covers a fixed amount plus interest, when is the fixed amount calculated to determine the amount of the interest owed - at default, acceleration, judgment, foreclosure, or some other date? Numerous issues are usually presented by this guaranty of interest issue.

■ **Percentage limits or dollar amount limits:** Sometimes the maximum liability of the guarantor is limited by a certain percentage of the loan or by a maximum dollar amount. In our experience, these types of guaranties are rarely drafted to address all of the situations that may occur and, therefore, the guarantor may have an opportunity to fashion a legal defense in certain circumstances.

For instance, suppose a \$20 million commercial loan with a partial guaranty that shall not exceed 50% of the principal amount of, and accrued interest on, the loan. The maximum liability of the guarantor appears to be \$10 million plus accrued interest.

What if the collateral for the loan is sold at a foreclosure sale for \$12

million? Is the guarantor's obligation fulfilled since he is only liable for the "first" \$10 million (i.e. 50% of the original loan), is the guarantor's liability reduced to \$8 million (i.e. the deficiency amount is less than \$10 million) or is the guarantor liable for \$4 million (i.e. 50% of the remaining amount owed)?

The actual text of the guaranty may provide the answer - or it may provide various options depending upon which provision is emphasized.

■ **Multiple guarantors:** When more than one guarantor executes a partial guaranty of the loan, additional interpretation issues are presented regarding the interplay between the guaranty agreement and the text of the limitation of liability provisions. For instance, if two guarantors sign separate guaranties covering 50% of the loan, does the lender have a combined guaranty of 100% of the loan or did both guarantors guaranty the same 50% amount? Again, the terms of each guaranty agreement must be carefully analyzed by experienced counsel in order to determine the meaning of the guaranty.

■ **"Bad boy" or "springing" guaranty agreements:** Certain loan transactions required the borrower's principals either to guarantee (i) the payment of damages caused to the lender by the occurrence of certain events or (ii) the entire loan, but only upon the occurrence of certain events. Although there are similarities among the language used in these types of guaranties, no standard "bad boy" or "springing" guaranty agreement exists. Accordingly, the actual language used in the guaranty must be carefully read and analyzed by experienced legal counsel in order to understand the scope of the guaranty and any possible defenses which may be available.

Conclusion

Real property values are decreasing and lenders are calling upon guarantors to make payments under partial guaranties. However, many of these guaranties were not well-drafted to cover all factual situations that may occur.

While certain foundational issues regarding commercial guaranties do not generally favor the guarantor, a careful analysis of the text of the partial guaranty may provide potential legal defenses for the guarantor that may level the playing field and enhance the opportunity to settle, or limit, the guarantor's obligations to the lender.

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