



FARELLA BRAUN + MARTEL LLP

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## **Guaranties of Debt in Default**

What to Do Now

(For Creditors and Guarantors)

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big firm know how + small firm know you

# Agenda

- Guaranties: Varieties, Common Myths and Realities
- Legalities: The Collection Process and Defenses to Enforcement
- Practical Limits: Bankruptcy, Insolvency and Exempt Assets
- Practical Resolutions and Pitfalls to Avoid
- Getting it Right Next Time: Negotiating the New Guaranty

# Guaranties: Vanilla and Beyond

- Guaranties, Indemnification Agreements, and Full Recourse Loans
- How Guaranties are Different: Independence, Defenses and Waivers
- Continuing / Single
- Conditional / Unconditional
- “Joint and Several” Guaranties
- Guaranties of Secured Debt
- Limited Recourse, Asset Carve-Out, and “Bad Boy” and Other Contingent Guaranties

# Guaranties: Lender Myths

- The Guarantor is Solvent, Because the (Old) Financial Statement Says So: Things Move Quickly
- I Don't Have to Worry About the Collateral, Because I've Got a Guaranty: Things Move Slowly
- The Guarantor Would Never File Bankruptcy
- There's Nothing I Can Do to Improve My Position

# Guaranties: Guarantor Myths

- The Lender Won't Sue Me Personally
- I Don't Have "Bad Boy" Guaranty Liability, Because I Haven't Done Anything Bad: the Amazing, Shrinking Non-Recourse Loan
- I Can Get Protection By Putting the Borrower in Bankruptcy
- The Legal System Takes Years, and by Then We'll Have This Worked Out
- "Bad Boy" Guaranties are not Enforceable

# Guaranty Collection: Process

- Demand on Guarantor: Typical, but not Required)
- Litigation Against Guarantor (Typically, in Connection with Action Against Borrower)
- Foreclosure on Collateral
- Prejudgment Attachment on Assets of Guarantor
- Judgment Against Guarantor
- Levy on Asset of Guarantor
- The “Joint and Several” Squeeze

# Guarantor Legal Defenses

- Generally Punish Increasing Underlying Obligation or Limiting Guarantor's Recovery
- Most Traditional Suretyship Defenses Can Be, and Are, Waived
- Modifying Underlying Debt Without Guarantor Consent
- Failure to Have "Commercially Reasonable" Sale of Personal Property
- Guarantors Can Waive California Real Property Collateral Antideficiency Statute Protections

# Guarantor Practical Defenses

- Bankruptcy (of Guarantor, Not Borrower) Halts Collection Actions on Guaranty
- Guarantor May Have No Non-Exempt Unencumbered Assets Available to Satisfy a Judgment
- The Leverage of New Money
- Guarantor's Future Earning Capacity May be Greatest Asset



# Asset and Exemption Planning

- Exemption Planning: Some Categories of Assets (Retirement Plans, Social Security Benefits) Are Exempt From Levy
- Asset Planning: Holding Assets Indirectly (Through an LLC) Means They Are Available to Creditors, But Cannot Be Seized and Liquidated Quickly
- Transfer Planning: Transferring Assets to Others While Insolvent Is Often “Fraud”

# Limits to Legal Planning

- Transfers with the Intent to Delay or Defraud Creditors Can Be Set Aside
- Transfers for Less than Reasonably Equivalent Value While Insolvent or Unable to Pay Debts Can Be Set Aside
- 2005 Bankruptcy Code Amendments Ended Most Abusive Homestead and Trust Asset Transfers
- Creditors' Remedies
- Criminal Liability

# Tax Impacts on Guarantors

- Guaranteed Debt is “Recourse” Debt
- Forgiveness of Recourse Debt Creates Discharge of Indebtedness Income Unless There Is an Exception
- Common Exceptions Include: Taxpayer or S Corporation is Insolvent; Taxpayer or S Corporation Is in Bankruptcy; Election to Take Tax Hit Over Time
- Planning Opportunities
- Separate Release of Guarantor OK

# Guarantors: What to Do Now

- Review Your Existing Guaranties Carefully
- If Putting in New Money, Modify Guaranty
- Consider All the Triggers of “Bad Boy” Guaranties Carefully and Very Early: Document Decisions
  - Settle “Joint and Several” Guaranties First
- Consider How You Hold and Encumber Your Assets
- In California, Give Real Property Security

# Guarantors: What Else to Do

- Consider Tax Consequences
- Offer Non-Monetary Consideration (Deed in Lieu, Cooperation, Knowledge etc.)
- Settle at the Bottom of the Market and Move on. (Owing More than You Can Pay Is a Practical Defense—Until the Market Turns Again.)

# Creditors: What to Do Now

- Get an Updated Financial Statement
- Get a Waiver of Defenses and Release in Any Workout
- Carefully Manage Personal Property Sales (and Consider Adding “Safe Harbor” Sales Procedure; Document Carefully)
- Improve Your Collateral Position
- Consider Tax Consequences and Whether They Give You Leverage

# Making Practical Deals

- Fast Acting Creditors Get More
- Non-Monetary Considerations Make Deals Work When There Isn't Enough Cash
- “Better than Bankruptcy” May Be the Best Deal
- A “Hope Certificate” Is Better than No Hope of Recovery

# Next Time

- Carefully Read and Negotiate Guaranties
- Unlimited Guaranties in a Cyclical Industry Guaranty  
Disaster: Cap or Carve-Out
- Cross-Collateralization, Limited Money Partner Guaranties,  
Guaranty Entities, and Letters of Credit Are Also Alternatives
- Contingent Liabilities Are Real: Get an Accurate Picture  
Beyond the Financials



# Upcoming Programs

- April 14, Working Out Problem Hotel (and Other Commercial Real Estate) Loans
- May Date TBD, Understanding Tax Impacts of Foreclosure and Debt Restructuring: Better Deals (with Uncle Sam's Money)

# Presenters

- Matthew Lewis, chair, corporate group [mlewis@fbm.com](mailto:mlewis@fbm.com)
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