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Clients&FriendsMemo

New York State Supreme Court Upholds Springing Guaranty in Granting Summary Judgment

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On March 8, 2011, in a decision enforcing a springing guaranty in a commercial real estate loan, the Supreme Court of the State of New York granted a motion for summary judgment in lieu of complaint pursuant to CPLR 3213.[1] In *UBS Commercial Mortg. Trust 2007-FL1, Commercial Mortg. Pass-through Certificates, Series 2007-FL1 v. Garrison Special Opportunities Fund L.P.*,[2] the court not only found that such springing guaranty was an instrument for the payment of money only, thus entitling Plaintiffs to move for summary judgment in lieu of complaint, but the court also found that such springing guaranty was neither an unenforceable penalty nor against public policy.

Non-Recourse Loans and Springing Guaranties

In commercial real estate finance, the obligations of a borrower under a mortgage loan are generally "non-recourse," thus prohibiting the mortgage lender from looking beyond the collateral (i.e. the property) to satisfy the loan in the event of a default by the borrower; in other words, if the mortgaged property serving as collateral is not sufficient to satisfy the debt, the mortgage lender has no further recourse and the borrower is not personally liable for its obligations, as would be the case with a "fully recourse" mortgage loan. While in recourse financing, the credit of a borrower or guarantor is available to satisfy the debt obligation in addition to the collateral pledged, in a non-recourse loan, the only "credit" that the lender has is the collateral which is mortgaged to secure the debt. Even in connection with "non-recourse" loans, however, recourse carve-outs are common and subject borrowers to personal liability in the event of certain enumerated occurrences (or bad acts), which typically include the filing of bankruptcy by the borrower among other "bad acts". Since the Borrower in a non-recourse loan is typically a single purpose bankruptcy remote entity with no assets other than the relevant mortgaged property, many non-recourse loans require that a sponsor of the borrower which has credit provide a guaranty of such non-recourse carve-outs

[1] C.P.L.R. sec. 3213.

[2] *UBS Commercial Mortg. Trust 2007-FL1, Commercial Mortg. Pass-through Certificates, Series 2007-FL1 v. Garrison Special Opportunities Fund L.P.*, No. 652412/10 (N.Y. Sup. Ct. Mar. 8, 2011) (order granting summary judgment).

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under which the sponsor/guarantor would be liable upon the happening of bad events, i.e., such liability "springs" into existence upon the occurrence of such events.

UBS Commercial Mortg. Trust 2007-FL1, Commercial Mortg. Pass-through Certificates, Series 2007-FL1 v. Garrison Special Opportunities Fund L.P.

The Facts

In *Garrison*, UBS Commercial Mortgage Trust 2007-FL1, Commercial Mortgage Pass-through Certificates, Series 2007-FL1, and Normandy Reston Office, LLC ("**Plaintiffs**") were successors-in-interest to UBS Real Estate Securities Inc., which in July 2007 loaned $107,000,000.00 (the "**Loan**")[3] to Penzance Cascades North, LLC, Penzance Cascades West, LLC, Penzance Parkridge Five, LLC and Penzance Parkridge Two, LLC (collectively, "**Borrowers**") for the acquisition of certain properties in Virginia (the "**Properties**"). Garrison Special Opportunities Fund L.P. ("**Defendant**") was successor-in-interest to the mezzanine lender, which held a mezzanine loan obtained by the equity owner of the Borrowers in the principal amount of $31,500,000.00 and which mezzanine loan was secured by a pledge of 100% of the membership interests in the Borrowers.

On September 28, 2010, Defendant and Plaintiffs entered into a Guaranty of Recourse Obligations (the "**Guaranty**") as a condition to Plaintiffs' agreement to forbear from foreclosing on the Properties after the Loan became due on August 9, 2010. Pursuant to the Guaranty, Defendant guaranteed certain obligations and liabilities of the Borrowers to the extent such obligations and liabilities arose after Defendant acquired any ownership interests in the Borrowers. Pursuant to the Guaranty, the Loan was fully recourse upon the filing by Borrowers of a voluntary petition under the Bankruptcy Code, in which case the obligations guaranteed pursuant to the Guaranty would become payable "immediately upon demand . . . , and without presentment, protest, notice, notice of protest, notice of non-payment, notice of intention to accelerate the maturity, notice of acceleration of the maturity, or any other notice whatsoever. . . ."[4]

Defendant acquired all ownership interests in the Borrowers on November 1, 2010 through a UCC foreclosure sale on the Properties, and each Borrower thereafter filed a voluntary petition for Bankruptcy on December 15, 2010 in the U.S. Bankruptcy Court for the Southern District of New York. Subsequently, Plaintiffs demanded payment of the Loan from Defendant pursuant to the Guaranty, and, after not having received payment, moved for a summary judgment in lieu of complaint pursuant to CPLR 3213, which provides that "[w]hen an action is based upon an

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[3] *Id.* at 1, n. 1 (noting that the present principal amount for which Plaintiffs sued is $111,514,324.00).

[4] *Id.* at 3 (quoting the Guaranty).

instrument for the payment of money only . . . the plaintiffs [sic] may serve with the summons a notice of motion for summary judgment and the supporting papers in lieu of a complaint."[5] The benefit of CPLR 3213 is speed. Procedurally, the litigation process is much quicker and efficient, allowing a plaintiff the ability to obtain a judgment against a guarantor defendant in a very expeditious manner.

The Analysis

In opposing the motion for summary judgment, Defendant made the following three arguments: (1) the Guaranty was not an instrument for the payment of money only; (2) the Guaranty was an unenforceable penalty; and (3) the Guaranty was against public policy.

With respect to the first argument, Defendant asserted that the Guaranty covered obligations to perform, in addition to obligations for payment, and necessitated reference to other documents in the transaction for the purpose of determining Defendant's liability under the Guaranty. The court, however, in holding that the Guaranty was an instrument for the payment of money only, stated that "the additional provisions present in the Guaranty do not require additional performance as a condition precedent to payment, and . . . the references to the underlying obligations do not add to or alter the guarantor's obligations."[6] In its discussion, the court cited *Bank of America, N.A. v. Solow*,[7] in which the court there stated that, "the need to consult the underlying documents to establish the amount of liability [under a guaranty] does not affect the availability of CPLR 3213," nor does "[t]he mere presence of additional provisions . . . , provided that the provisions do not require additional performance as a condition precedent to repayment, or otherwise alter the defendant's promise of payment."[8] In *Solow*, the guaranty at issue contained "a straightforward unconditional promise to pay the money on [sic] the maturity date. That and defendant's acknowledgment of the amount owed constitute a prima facie case."[9]

As to Defendant's second argument, the court agreed with the Plaintiff in finding that Defendant, "a sophisticated distressed real estate investor,"[10] waived its right to assert that the Guaranty was an unenforceable penalty, and upheld such waiver as a feature "almost uniformly" contained in

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[5] C.P.L.R. sec. 3213.

[6] *Garrison*, No. 652412/10, at 6.

[7] *Bank of America, N.A. v. Solow*, 2008 WL 1821877 (N.Y. Sup. Ct. Apr. 17, 2008), aff'd 59 A.D.3d 305 (N.Y. App. Div. 2009).

[8] *Garrison*, No. 652412/10, at 5 (quoting *Solow*).

[9] *Id.* at 6 (quoting *Solow*).

[10] *Id.* at 7.

guarantees and upheld by courts as part of "valid financing arrangements."[11] While having found that Defendant waived its right to assert that the Guaranty was an unenforceable instrument, however, the court proceeded to also address whether the Guaranty was in fact an unenforceable instrument. In its discussion regarding such enforceability, the court stated that Defendant "made a decision to take a calculated risk . . . ," and was familiar with the "mechanics and purpose" of the Guaranty, which similar guaranties are "recognized as legitimate financing arrangements. . . and have been upheld in New York State and federal court."[12] The court, therefore, found that the Guaranty was not an unenforceable penalty.

Lastly, the court addressed Defendant's public policy argument that, since the guarantor in a springing guaranty is typically both the principal of the borrower and the individual determining or authorizing borrower's filing of bankruptcy, such guaranty could create a conflict of interest causing the guarantor to "refrain from filing the borrower into Chapter 11, to the detriment of the borrower's creditors and in breach of the manager's fiduciary duties to those creditors."[13] Defendant further argued that the Guaranty allowed for "an aggressive lender . . . [to] play 'hold up' and insist upon sweetheart deals not available in bankruptcy," thus "preventing the efficient restructuring of stressed mortgage debt and pushing real estate finance into a crisis position."[14] In rejecting Defendant's argument, and noting that Defendant does not support such argument with precedent, the court stated that it is "charged with upholding freely entered into contractual arrangements in accordance with common law precedents and the rules of legislative interpretation," and that if there is a need to address the rules of commercial real estate finance, it is "the operation of a legislative or executive function that is called for."[15]

Conclusion

In finding against the Defendant on all three of its arguments against the motion for summary judgment, the court in *Garrison* distinguished the facts of the cases cited by Defendant from the facts at hand and its decision reinforces springing guaranties in commercial real estate transactions such that a carefully drafted guaranty of recourse carve-outs should be respected in New York.

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[11] *Id.* at 8.

[12] *Id.*

[13] *Garrison*, No. 652412/10, at 9 (quoting Defendant's Memorandum, p. 19).

[14] *Id.*

[15] *Id.* at 10.

If you have any questions about this memorandum, please feel free to contact any of the following attorneys:

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