Quick Enforcement of Guaranties Triggered by Bankruptcy

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Lenders rely on nonrecourse carveout guaranties for protection against borrower bankruptcies. The courts seem quite willing to enforce those protections.

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Commercial mortgage lenders don't like it when their borrowers file bankruptcy. That's because, among other things, the lender's claim is often "crammed down" in bankruptcy to some lower amount based on the temporarily impaired value of their collateral. The process also causes delay and prevents the lender from enforcing the loan documents in accordance with their terms.

In response, when commercial mortgage lenders make nonrecourse loans they often require the principals of the borrower to sign "nonrecourse carveout" guaranties. By signing one of these guaranties, the individual people who control the borrower become personally

obligated to pay the entire loan if, for example, the borrower files bankruptcy. This way, the people who control the borrower, and often have substantial assets, have every incentive to keep it out of bankruptcy.

A recent case underscores the willingness of New York courts to enforce nonrecourse carveout guaranties triggered by bankruptcy, and to do so rather expeditiously. The case also showed that if a lender includes certain “magic language” in the guaranty intended to speed along the litigation process, the courts will enforce that too.

The initial facts of the case have become very familiar in today’s real estate markets. An optimistic investor bought a large piece of commercial real estate in the fall of 2019, financing most of the purchase price with a relatively low-interest mortgage. A few months after closing, the borrower defaulted by failing to deposit certain funds. Not long after that, the COVID pandemic arrived, triggering more defaults.

In December 2020, the borrower filed bankruptcy. That filing triggered language in the guaranty, making the guarantor liable for the entire “Debt” – everything owed under the loan documents – if the borrower filed bankruptcy. A little over a year went by. The original lender sold the loan to another lender. After about another year, in February 2023, the second lender sued to enforce the guaranty.

In that litigation, the lender relied on a special procedure available under New York law. Most litigation starts when a plaintiff files a “complaint” – which then requires an “answer” and potentially other procedural skirmishing. In contrast, New York law says that if a plaintiff wants to enforce an “instrument for the payment of money only,” then the plaintiff can immediately sue for “summary judgment in lieu of complaint,” which can skip a few steps in the litigation.

In this particular litigation, the guaranty included language where the guarantor acknowledged the guaranty was an “instrument for the payment of money only,” and even confirmed the lender could proceed under New York’s special expedited procedure.

The guarantor argued that the guaranty didn’t qualify for the expedited procedure and raised a few other issues. Some of those issues related to calculation of the amount due under the guaranty. And the guarantor challenged the default interest rate of 24% provided for in the loan documents.

Eight and a half months after the lender filed suit, the court rejected nearly all the guarantor’s arguments, issuing a judgment in favor of the lender on nearly all its claims, including its claim for 24% default interest through date of judgment. The guarantor now faces personal liability on a $50,000,000 judgment. In other words, all the guarantor’s assets are at risk, exposed to the lender’s claims.

As the rather obvious first lesson of this case, when a guarantor signs a nonrecourse carveout guaranty triggered by bankruptcy, a guarantor should assume the courts will enforce that guaranty. This one did. And both the extensive waiver language in the guaranty and New York's special procedure for any "instrument for the payment of money" helped the lender achieve an extraordinarily quick and favorable result.

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