LOAN GUARANTIES: ADVANCED ISSUES

COMMERCIAL REAL ESTATE FINANCE: BEYOND THE BASICS

THE CHICAGO BAR ASSOCIATION

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John C. Murray
Vice President - Special Counsel
First American Title Insurance Company
Chicago National Commercial Division
30 N. LaSalle Street, Suite 310
Chicago, IL 60602
(800) 333-3993

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Introduction

A debtor may transfer assets before a bankruptcy filing, often to relatives or related entities, in order to protect these assets from being included in the debtor's estate and, therefore, subject to the claims of creditors. The purpose of § 548 of the Bankruptcy Code ("Code") is to avoid such fraudulent transfers. As one court has stated, "[t]the policy underlying § 548 [the fraudulent conveyance section of the Bankruptcy Code] is to protect creditors against the depletion of a bankruptcy estate through transfers of the debtor's interests in property taking place within one year before the bankruptcy petition was filed." *Max Sugarman Funeral Home, Inc. v. A.D.B. Investors*, 926 F.2d 1254, 1254 (1st Cir. 1991). Section 548 is derived from the Statute of 13 Elizabeth passed by the English Parliament in 1571. Statute 13 of Elizabeth "was aimed at a practice by which overburdened debtors placed their assets in friendly hands thereby frustrating creditors' attempts to satisfy their claims against the debtor." *Mellon Bank, N.A., v. Metro Communications, Inc.*, 945 F.2d 635, 644-45 (3rd Cir. 1991). Under § 548 of the Code, fraudulent conveyances may be set aside if they are made within one year prior to the filing of a petition in bankruptcy.

State Fraudulent Transfer Statutes

The fraudulent transfer provision of the Code, § 548(a)-(b), applies not only to transfers made by the debtor within one year before the commencement of the bankruptcy case, but also incorporates state fraudulent conveyance statutes. Both state law and the Code contain provisions that make transfers under certain circumstances void as to creditors of the transferor (the seller in the case of a sale transaction; the borrower in the case of a loan transaction). A transfer would violate these laws and may be voided by the trustee or debtor in possession if it is either intentionally fraudulent or constructively fraudulent as to the transferor's creditors.

Fraudulent conveyances may also occur under the Uniform Fraudulent Conveyance Act ("UFCA") or the Uniform Fraudulent Transfer Act ("UFTA") because § 544 of the Code gives the debtor or the trustee the status of a creditor as of the date of the petition. State fraudulent conveyance statutes do not require that the transfer be made within one year prior to the filing of the petition in bankruptcy because the action is independent of bankruptcy. However, if the trustee elects to proceed under state fraudulent conveyance laws, state statutes of limitation control. The UFTA, which has been adopted by 40 states, contains its

own statute of limitations. Under §§ 9(a) and 9(b), the UFTA extinguishes any claim not brought within four years after the transfer was made or the obligation was incurred. Under § 9(c), challenges to insider preferences must be brought within one year. Because the substantive claim terminates at the end of a specified time period, a bankruptcy trustee or an agent of the federal government, such as the IRS, may be barred from asserting remedies under the UFTA after the expiration of the specified time period even though general statutes of limitation are unenforceable against the federal government in some cases.

Definition of "Transfer"

Section 101(54) of the Code defines "transfer" as "every mode, direct or indirect, absolute or conditional, voluntary or involuntary, of disposing of or parting with property or with an interest in property, including retention of title as a security interest and foreclosure of the debtor's equity of redemption." The date of transfer, for fraudulent conveyance purposes, is the date on which the transfer would have become perfected against a subsequent bona fide purchaser under applicable state law.

A debtor may make a "transfer" by, among other things, incurring a debt or obligation or providing a guaranty, making a payment, granting a lien or security interest on its assets, or transferring all or a portion of its property. To constitute a fraudulent transfer under § 548(a)(1) of the Code, the transfer must be made with actual intent to hinder, delay, or defraud a creditor. Actual intent to defraud need not be shown by direct evidence, but may be inferred from the circumstances surrounding the conveyance, including reckless disregard of the consequences of the transaction and the subsequent conduct of the parties.

A transfer is also deemed to be constructively fraudulent under Section 548(a)(2) of the Code and may be set aside if, within one year prior to the filing of the bankruptcy petition, the creditor receives "less than reasonably equivalent value" in a transaction *and* the transaction does not meet any one of the following requirements: (1) the transferor was insolvent at the time of the transfer or was rendered insolvent as the result of the transfer, (2) the transferor was undercapitalized at the time of the transfer or became undercapitalized as the result of the transfer, or (3) the transferor was unable or rendered

unable by the transfer to pay its debts as they became due. (These tests are sometimes referred to as the "insolvency test," the "capitalization test," and the "cash flow test"). Upon avoidance of the transfer, the property would then be transferred back to the estate, subject to a lien for whatever price was paid for the asset. Inadequate consideration would not apply to sales at the market price that would generally benefit creditors and are not voidable.

Guaranties as Constructively Fraudulent Transfers

Constructively fraudulent transfers may be deemed to have occurred as the result of "upstream" or "sidestream" transfers (and. less often, "downstream" transfers), and other similar transactions, such as the following: leveraged buyouts; asset purchases where the seller's debts are assumed; mortgage loans to finance partner buyouts; transfers of all or a portion of the mortgage proceeds to a parent or sister entity without adequate consideration; guarantees of the mortgage indebtedness of a parent or sister entity (often securitized by a second mortgage on the property); cross-collateralization of existing mortgages with mortgage obligations owed by others; mortgages to secure debt proceeds distributed as dividends; transfers of assets to general partners; and the issuance of partnership or other equity interests in exchange for the contribution of real property(ies). Any of these transactions, depending on the facts, could result in a transfer for less than adequate consideration (i.e. "reasonably equivalent value") or cause the person or entity making the transfer to become insolvent.

With respect to intercorporate guaranties, courts have classified such transactions "into three categories: first, where a parent corporation or principal guarantees a subsidiary's obligation is termed a downstream guaranty; second, where a subsidiary guarantees the obligation of its sister corporation is termed a cross-stream guaranty; and third, where a subsidiary guarantees the parent's obligation is termed an upstream guaranty." ***Commerce Bank of Kansas City v. Achtenberg*****, 1993 U.S. Dist. LEXIS 16136 (W.D. Mo. Nov. 10, 1993) (Not reported in F.Supp.), at * 12 n.4 (citing** ***In re Metro Communications, Inc.*****, 95 B.R. 921, 923 (Bankr. W.D. Pa. 1989).**

An upstream loan transaction generally refers to any lending transaction where all or some portion of the loan proceeds are distributed directly to the owners of the borrowing entity. A sidestream loan transaction refers to the situation where all or some of the proceeds are distributed directly to an affiliated or "sister" entity. In either event, a fraudulent transfer may occur, under state law and/or under Section 548 of the Code, because the mortgagor (who has not received the proceeds) remains obligated for the debt or has encumbered the mortgaged premises as security for the loan and may not have given reasonably equivalent value. Obligations that debtors incur solely for the benefit of third parties are presumptively not supported by a reasonably equivalent value. *See, e.g., Rubin .v Manufacturers Hanover Trust Co.,* 661 F.2d 979, 989 (2d Cir. 1981); *Marquis Products, Inc. v. Conquest Mills, Inc. (In re Marquis Products, Inc.)*, 150 B.R. 487, 491 (Bankr. D. Me. 1993) ("It may be said that, as a general rule, an insolvent debtor receives 'less than a reasonable equivalent value' where it transfers its property in exchange for a consideration which passes to a third party. In such a case, it ordinarily receives little or no value," *quoting Ear, Nose & Throat Surgeons of Worcester, Inc. v. Guaranty Bank & Trust Co.*, 49 B.R. 316, 320 (Bankr. D. Mass. 1985)).

The transaction may also render the mortgagor entity insolvent, under capitalized, or unable to meet its current debt obligations. On the other hand, "downstream" transfers, involving transfers by the debtor parent corporation to a (solvent) subsidiary, are generally presumed to be for reasonably equivalent value because the parent, which is usually the sole stockholder of the subsidiary, also receives any benefit that accrues to the subsidiary as the result of the transfer. There is thus deemed to be an "identity of interest" between the parties. With respect to a payment or guarantee by a debtor corporation of a loan to its wholly owned subsidiary, theoretically the reduction of the subsidiary's debt by virtue of payments thereunder increases, on a dollar-for-dollar basis, the value of the stock in the subsidiary owned by the parent. *See Branch v. FDIC*, 825 F.Supp. 384, 400 (D.Mass. 1993) (["t]his court is aware of no case in which transfers to a solvent subsidiary have been determined to be for less than equivalent value"); *In re Metro Communications, Inc.*, 95 B.R. 921, 933 (Bankr. W.D. Pa. 1989), *rev'd on other grounds*, 945 F.2d 635 (3rd Cir. 1991); *Rubin v. Manufacturers Hanover Trust Co.*, 661 F.2d 979,

991 (2nd Cir. 1981) (holding that § 548 of the Code does not authorize avoiding a transfer that "confers and economic benefit upon the debtor," either directly or indirectly).

However, this presumption may be rebutted by evidence to the contrary. *See, e.g. Commerce Bank of Kansas City, N.A. v. Achtenberg*, No. 90-0950-CV-6, 1993 WL 476510 (Nov. 10, 1993) (Not reported in F.Supp) (finding, with respect to downstream guaranties of a corporate loan by two individuals who were the corporation's sole shareholders, that the debtor corporation was insolvent at the time of the guaranties and that such insolvency eliminated any indirect benefit to the shareholders-guarantors; the court noted, however, that if the debtor was only "marginally insolvent" at the time of the transfer, reasonably equivalent value might be found to exist). In *General Electric Credit Corp. v. of Tennessee v. Murphy (In re Rodriguez)*, 895 F.2d 725 (11th Cir. 1990), the court held that the debtor corporation did not receive reasonably equivalent value where its individual shareholder guaranteed the debt of the debtor corporation's wholly owned subsidiary but the debtor corporation acted as if it were the guarantor and actually made the loan payments to the lender after the loan was in place. The court found that the payments by the debtor corporation did not create any equity in the subsidiary's sole asset, a jet aircraft, which had been sold by the lender for less than half of the remaining loan amount and that the debtor corporation did not benefit directly or indirectly from reducing a debt it was not liable for. The court suggested that reasonably equivalent value might have been demonstrated had the debtor corporation itself entered into a guaranty with the lender at the time of the original loan because use of the loan proceeds by the subsidiary would have been of benefit to the debtor corporation.

Reasonably Equivalent Value

When analyzing whether reasonably equivalent value exists in connection with a "cross-stream" or "side-stream" guarantee by a corporation of a sister entity's debt, the courts often focus on whether such guaranties are customary and reasonably expected by creditors, and whether such obligations enhance the financial strength of the entire corporate "group" either directly or indirectly and therefore provide value to all of

the members. If, instead, the result of such guaranties is that the creditors of a high-performing solvent entity are put at increased (and unreasonable) risk for the sake of an affiliated entity that is insolvent or on the brink of insolvency, then courts are more likely to find that the transfer was made for less than reasonably equivalent value and therefore fraudulent. Often, the subsidiaries are of varying financial strength, and creditors of a stronger subsidiary may be put at increased and unreasonable risk as a result of the cross-guaranty. The courts will analyze closely whether the cross-guaranty obligation results in a true benefit to the debtor, such as increased synergy with the group or increased credit availability, and whether the corporate group as a whole was a viable business enterprise at the time of the guaranty. ***See Mellon Bank, N.A., v. Metro Communications, Inc.*****, 945 F.2d 635, 647 (3rd Cir. 1991),** ***cert. denied,*** **112 S.Ct. 1476 (1992);** ***Telefast, Inc. v. VU-TV, Inc.*****, 591 F.Supp. 1368 (D. N.J. 1984); Barry L. Zaretsky,** ***Fraudulent Transfer Law as the Arbiter of Unreasonable Risk*****, 46 S.C. L. Rev. 1165, 1193-96 (1995); Robert J. Rosenberg,** ***Intercorporate Guaranties and the Law of Fraudulent Conveyances*****:** ***Lender Beware*****, 125 U. Pa. L. Rev. 235 (1976); Jack F. Williams,** ***The Fallacies of Contemporary Fraudulent Transfer Models as Applied to Intercorporate Guaranties: Fraudulent Transfer Law as a Fuzzy System*****, 15 Cardozo L. Rev. 1403 (1991).**

The existence of an upstream transfer, where the consideration has passed to a third party, does not conclusively establish that the transferor did not receive reasonably equivalent value. A subsidiary that guarantees a parent's debt could, for example, receive indirect benefits such as securing a future sale, obtaining a line of credit otherwise unavailable, or even improving its public image or "goodwill" through consummating a large transaction. ***See, e.g., Telefast, Inc. v. VU-TV*****, 591 F.Supp. 1368, 1379 (D.N.J. 1984);** ***Marquis Products, Inc. v. Conquest Carpet Mills, Inc. (In re Marquis Products, Inc.)*****, 150 B.R. 487, 491 (1993) ("a subsidiary receives an indirect benefit where its upstream guarantee enables its parent to procure a loan and, thus, to provide funds to the subsidiary");** ***Mellon Bank, N.A. v. Metro Communications, Inc.*****, 945 F.2d 635, 647 (3rd Cir. 1991) ("it is appropriate to take into account intangible assets not carried on the debtor's balance sheet, including, inter alia, good will").**

Upstream, downstream, and cross-stream transactions can also be effected through cross-collateralization, even in the absence of a formal guaranty. To pledge one's assets as security for the obligation of another is to become a guarantor regardless of whether any document evidencing the guaranty obligation is executed. Cross-collateralization is a very common structuring technique in securitized loan transactions today. Typically, as required by the lender, a "bankruptcy remote" or "special purpose" entity ("SPE") is created, to which certain assets of a parent entity will be conveyed that are intended to act as security for a loan.

The purpose this "bankruptcy remote" structure is to make it difficult for the SPE borrower to file bankruptcy. However, bankruptcy "remote" does not mean bankruptcy "proof." In many commercial transactions, it is not uncommon to create as many bankruptcy-remote entities as there are real property assets or, in multi-state transactions, to form as many bankruptcy- remote borrowing entities as there are states. Each newly created entity typically will be an SPE that is wholly owned by the parent entity (although not always on a direct basis; the entity formed to hold title to the real property asset may be owned by another entity or entities, often itself or themselves a bankruptcy-remote SPE or SPEs, which entity or entities may in turn be wholly owned by the ultimate parent).

The ultimate purpose of the loan may simply be to refinance existing secured debt. If the loan were made to the parent, which pledged its own assets as security for the loan, and the proceeds were used to pay off the parent's existing secured debt, there would likely be no creditors' rights issue and the title insurer could be expected to insure the transaction without a creditors' rights exclusion or exception. However, because the lender (or the rating agency that will be rating the transaction if it is to be securitized) desires to isolate the assets that will be the security from the parent's general business operations (and other creditors), a bankruptcy-remote SPE will be the preferred form of borrowing entity.

There are at least two transfers in these transactions that must be analyzed for creditors' rights issues by title insurers. The first is the transfer of title from the parent to the newly created entity or entities of the assets that will be the security for the loan. The second is the mortgaging of those assets by the newly formed entity or entities. The actual borrower may be the parent (in which event the transaction becomes in effect becomes an upstream guaranty), but it is usually the bankruptcy-remote SPE itself. A separate loan might be made to each SPE, secured by the asset or assets of that particular SPE received from the parent. If the structure stopped there, and assuming that the loan being refinanced became the obligation of the SPE at the time title to the asset or assets was conveyed by the parent to the SPE (and also assuming that the parent received "reasonably equivalent value" for its transfer to the SPE), the loan transaction involving the existing secured debt might not involve a creditors' rights issue (except possibly an intentional fraudulent transfer). However, rarely is this type of loan transaction structured as a series

of truly "stand alone" loans to each separate SPE. Instead, each SPE pledges its asset or assets as security for its own promissory note *and* for the promissory notes executed by each of the other "sister" SPEs. There may in fact be a formal guaranty by each SPE of the indebtedness of each of these other SPEs (which in turn may be secured by a subordinate mortgage on each of the other properties mortgaged by the respective SPEs). This results in cross-collateralization, as each asset stands as collateral for the "global" loan (being the sum of all of the separate loans made to each SPE), although each individual SPE has only benefited from a portion of the loan proceeds.

The common theme in upstream, downstream and cross-stream transactions is that someone other than the entity whose assets stand as security for the loan is benefiting from the loan proceeds and - at least to the extent of the benefit flowing to the parent, subsidiary or sister entities - the "transferring" entity is not receiving reasonably equivalent value. Therefore, a fraudulent transfer challenge can be made by the creditors (or bankruptcy trustee) of the parent, who could attack the transfer to the SPE as one (1) made to "hinder, delay or defraud" the parent's existing or future creditors, or (2) that rendered the parent insolvent, or (3) that left the parent with insufficient capital to carry on its business, or (4) that occurred when the parent was unable to pay its debts as they became due. The SPE's creditors (or bankruptcy trustee) could also challenge the transaction as a fraudulent transfer, based on some or all of the same theories. The transfer of assets by a parent to a subsidiary also could constitute a preference if the parent had guaranteed the subsidiary's indebtedness, and is subsequently released from the guaranty obligation when the subsidiary uses the proceeds to of the new secured loan to satisfy an existing obligation of the subsidiary that the parent had guaranteed.

Leveraged Buyout Transactions

Concerns about upstream transfers and guaranties were highlighted in the 1980s, when courts began to apply fraudulent conveyance law (both state and federal) to leveraged buyout transactions. A leveraged buyout refers to the acquisition of a "target" corporation in which all or a substantial portion of the purchase price paid for the stock of the target corporation is borrowed from a third party and where the loan financing the transaction is secured by the assets of the target corporation. Usually the buying entity infuses little or none of its own funds as equity, and therefore the transaction results in equity being exchanged for debt.

Upstream transactions are characterized, in the case of leveraged buyout transactions, by subsidiary guaranties of the debt obligations of the guarantor's new parent corporation to the lender that financed the acquisition of the stock of the subsidiary-guarantor. In a leveraged buyout transaction, the transferor generally receives less than reasonably equivalent value because it conveys the property in exchange for consideration that passes

to a third party. As one court has stated, "The target corporation . . . receives no direct benefit to offset the greater risk of now operating as a highly leveraged corporation." *Mellon Bank v. Metro Communications, Inc. (In re Metro Communications, Inc.)*, 945 F.2d 635, 646 (3rd Cir. 1991); *cert. denied sub nom. Committee of Unsecured Creditors v. Mellon Bank, N.A.*, 503 U.S. 937, 112 S.Ct. 1476 (1992). The court in *Mellon Bank* noted that:

> The effect of an LBO is that secured creditors replace a corporation's shareholders. Put simply, stockholders' equity is supplanted by debt. The level of risk facing the newly structured corporation rises significantly due to the increased debt to equity ratio. This added risk is borne primarily by the unsecured creditors, those who will most likely not be paid in the event of insolvency.
>
> 945 F.2d at 646.

Where it is alleged that the lender knew that the borrowing entity would not receive the loan proceeds but would nevertheless assume responsibility for repaying the debt, and it is further alleged that the eventual insolvency and bankruptcy of the borrower were foreseeable results of the leveraged buyout, the trustee in bankruptcy has adequately pleaded a cause of action for fraudulent conveyance and may seek to "collapse" the various loans, stock purchases and repayment obligations into one transaction. *See, e.g., CPY Co. v. Ameriscribe Corp. (In re Chas. P. Young Co.)*, 145 B.R. 131, 137 (Bankr. S.D.N.Y. 1992) ("[r]egardless of the number of steps taken to complete a transfer of debtor's property, such as in a leveraged buyout transaction, if they reasonably collapse into a single integrated plan and either defraud creditors or leave the debtor with less than equivalent value post-exchange, the transaction will not be exempt from the Code's avoidance sections").

The lender may be required to make a reasonable determination that the leveraged buyout is consistent with the rights of the borrower's (i.e., the target company's) unsecured creditors before disbursing the loan funds, because it is essential to view such transactions from the perspective of such creditors. Also, when a target company assumes liabilities or transfers security interests in its property and the consideration (or loan proceeds) is immediately passed to the target company's shareholders or third parties, lack of fair or reasonable consideration is usually presumed. *See United States v. Gleneagles Inv. Co.*, 565 F.Supp. 556 (M.D. Pa. 1983)*, aff'd in part and vacated in part sub nom United States v. Tabor Court Realty Corp.*, 803 F.2d 1288 (3d Cir.1986), *cert. denied sub nom. McClellan Realty Corp. v. United States*, 483 U.S. 1005, 107 S.Ct. 3229 (1987). *See also Ferrari v. Barclays Business Credit (In re Morse Tool, Inc.)*, 108 B.R. 389, 391 (Bankr. D. Mass. 1989); *Wieboldt Stores v. Schottenstein*, 94 B.R. 488, 499 (N.D. Ill. 1988); *MFS/Sun Life High Yield Series v. Van Dusen Airport Services Co.*, 910 F.Supp. 913 (S.D.N.Y. 1995); *In re Ohio Corrugating Co.*, 91 B.R. 430, 435 (Bankr. N.D. Ohio 1988)*, In re Revco, Inc.*, 118 B.R. 468, 518 (Bankr. N.D. Ohio 199); *Aluminum Mills Corp. v. Citicorp North America, Inc.*, 132 B.R. 869, 886-87 (N.D. Ill. 1991); *In re Resorts Int'l, Inc.*, 145

B.R. 412, 457-58 (Bankr. D. N.J. 1990) ("[c]ourts have not hesitated to apply state fraudulent conveyance law to leveraged buyouts, particularly in cases where there is evidence of intent to defraud and knowledge of the LBO"); *Crowthers McCall Pattern, Inc. v. Lewis*, 129 B.R. 992, 998 (S.D.N.Y. 1991) ("under the fraudulent conveyance laws, a lender is required to make a reasonable determination that the buy out is consistent with the rights of creditors before advancing funds"); *Orr v. Kinderhill Corp.,* 991 F2d 31, 36 ((2nd Cir. 1993) (finding a fraudulent conveyance under state law, where the lender knew that the net effect of its mortgage loan was a transfer of the property without any benefit to the debtor-transferor); Baird & Jackson, *Fraudulent Conveyance Law & Its Proper Domain*, 38 Va. L.Rev. 829 (1985); Murdoch, Sartin & Zadek, *Leveraged Buyouts & Fraudulent Transfers: Life After Gleneagles,* 43 Bus. Law. 1 (1987); Kirby, McGuinness & Kendell, *Fraudulent Conveyance Concerns in Leveraged Buyout Lending,* 43 Bus. Law. 27 (1987).

But see Mellon Bank v. Metro Communications, Inc. (In re Metro Communications, Inc.), 95 B.R. 921, 932-33 (Bankr. W.D. Pa. 1989), *rev'd on other grounds),* 945 F.2d 635 (3rd Cir. 1991); *cert. denied sub nom. Committee of Unsecured Creditors v. Mellon Bank, N.A.*, 503 U.S. 937, 112 S.Ct. 1476 (1992) (ruling that, although the bankruptcy statute prohibiting fraudulent transfers applies to leveraged buyouts, there is no *per se* rule that a leveraged buyout loan collateralized with the target's own assets renders the target debtor insolvent and, therefore, automatically vulnerable to a fraudulent transfer attack); *Wieboldt Stores, Inc. v. Schottenstein, supra*, 94 B.R. at 500 ("Although . . . fraudulent conveyance laws generally are applicable to [leveraged buyout] transactions, a debtor cannot use these laws to avoid any and all [such transactions]"); *Ohio Corrugating Co. v. DPAC, Inc.*, 91 B.R. 430, 439-40 (Bankr. N.D. Ohio 1988) (holding that the transaction was not a fraudulent conveyance because the plaintiffs had failed to prove that the defendant was insolvent at the time of the leveraged buyout): *Kupetz v. Wolf*, 845 F.2d 842, 847-49 (9th Cir. 1988) (refusing to find a fraudulent conveyance as the result of the sale of a debtor corporation in a leveraged buyout where there was no actual intent to defraud and the shareholders had no knowledge of the LBO structure used to purchase their shares; the court declined to analyze a leveraged buyout under the constructive fraud provisions of the California UFCA on the theory that it would be "inappropriate to utilize constructive intent to brand most, if not all, LBOs as illegitimate").

Strategies to Minimize Risk

Since the early 1980s, borrowers (and title companies) have struggled to come up with a method of minimizing the risks of fraudulent conveyances in mortgage loan transactions (especially in connection with multi-property and multi-state transactions), while still providing lenders the protections that they are seeking when utilizing devices such as upstream and sidestream guaranties.

Proposed solutions, which have been used with varying degrees of acceptance and success, include the following:

(1) a "net worth guaranty" (a sample form of which is attached hereto as **Exhibit "A")**, under which the guarantor guarantees all or a portion of another party's indebtedness or the aggregate indebtedness of numerous parties, but in an amount not greater than, e.g., 95 percent of its net worth on an ongoing basis in order avoid rendering the guarantor insolvent;

(2) statements or provisions in the guaranty agreements, and any mortgages securing such guaranty obligations, to the effect that it is the parties' intention that the obligations of each guarantor shall not constitute a fraudulent transfer or conveyance under the Code or any applicable state law (sample forms of such provisions are attached hereto as **Exhibits "B" and "C"**);

(3) a separate affidavit and certificate as to the organizational and financial status of the guarantor(s) and the debts and liabilities of the guarantor(s) (a sample form of which is attached hereto as **Exhibit "D"**);

(4) a "contribution agreement" among all the borrowers-guarantors providing that in the event that any individual borrower-guarantor guaranteeing the indebtedness of other borrowers-guarantors is required to, and actually does, make a payment on such guaranty for the benefit of another borrower-guarantor, it will thereupon have a right of indemnification against the defaulting borrower-guarantor for the amount (which may be an allocated portion of the aggregate debt) paid by the non-defaulting borrower-guarantor (a sample form of which is attached hereto as **Exhibit "E"**); and

(5) an indemnification agreement from the common principal or parent of each borrowing entity (which entities are commonly bankruptcy-remote "pass through" SPEs) to the title insurance company (which indemnity may or may not be secured by additional collateral such as a cash deposit, certificate of deposit, or letter of credit), indemnifying the title company for any claims successfully asserted against it as the result of the failure of the lender to realize on its security because a fraudulent transfer has been deemed to have occurred as a result of the transaction.

Notwithstanding their increasing use and the benefits provided by such documents, net worth guaranties may have the following disadvantages:

(1) the transaction may still be deemed a fraudulent transfer because it fails one of the tests, other than insolvency, under Section 548 of the Code, i.e., the guaranty causes the guarantor to fail either the capitalization test or the cash flow test;

(2) the difficulty of determining and verifying the actual net worth of the guarantor (or multiple guarantors) at any given point in time;

(3) the potential inability to collect the full amount of the guaranty because of the guaranty agreement's limitation to a specified amount of the guarantor's net worth and the possible miscalculation or misrepresentation of such net worth; and

(4) the lack of reported court decisions determining the validity and enforceability of net value guaranties.

Based on the case law over the past several years, lenders may in fact be safer (or just as safe) taking a full, unrestricted guaranty from each of the guarantors. For example, in *In re Xonics Photochemical, Inc.*, 841 F.2d 198, 200 (7th Cir. 1988), the court held that the amount of a subsidiary's liability on an upstream limited guaranty must be discounted by the probability that the contingency (payment on the guaranty) will actually occur. As a result of this ruling, the possibility that a court will find that a guarantor's payment obligations on an aggregate indebtedness will render the guarantor insolvent has been lessened, because the contingent obligation must be discounted. In addition, a "full value" guaranty, when used in the proper circumstances, may eliminate or reduce the risks of litigation, collection and uncertainty of enforceability that are inherent in net worth guaranties. Also, the contingent nature of a particular guarantor's liability may have to be further adjusted based on the guarantor's rights (commonly contained in commercial loan guaranties) of subrogation, indemnification, and reimbursement against the defaulting guarantor(s) or the primary obligor.

See also Official Comm. of Former Partners of Brennan (In re Labrum & Doak), 227 B.R. 383, 389 (Bankr. E.D. Pa. 1998) (suggesting a per se rule that future rent obligations are contingent liabilities and are to be excluded for insolvency valuation purposes); *Covey v. Commercial Nat'l Bank of Peoria*, 960 F.2d 657, 660-62 (7th Cir. 1992); ("[d]iscounting a contingent liability by the probability of its occurrence is good economics and therefore good law"); *Davis v. Suderov (In re Davis),* 169 B.R. 285, 302-03 (E.D. N.Y. 1994) ("In order to value a contingent liability, a bankruptcy court must determine the likelihood that the contingency will occur, and multiply the total debt guaranteed by that probability"); *Mellon Bank, N.A., v. Metro Communications, Inc.*, 945 F.2d 635, 648 (3rd Cir. 1991) (requiring that the value of the guaranty be reduced to the extent that the guarantor was entitled to contribution from co-guarantors at the time of the loan); *In re Chase & Sanborn Corp.*, 904 F.2d 588, 594 (11th Cir. 1990), ("a contingent liability cannot be valued at its potential face amount; rather, 'it is necessary to discount it by the probability that the contingency will occur and the probability will become real'" (quoting *In re Xonics Petrochemical, Inc.*, 841 F.2d198, 200 (7th Cir. 1988)); *In re Hemphill*, 18 B.R. 38, 47 (S.D. Iowa 1982) ("If the guarantee obligation is to be included among the debtor's liabilities for purposes of determining his insolvency, then the subrogation and contribution rights against other collateral must also be taken into account"); Brad R. Godshall and Robert A. Klyman, *"Wading 'Upstream' in Leveraged Transactions:*

Traditional Guarantees v. 'Net Worth' Guarantees," 46 Bus. Law. 391 (1991). *cf. Commerce Bank of Kansas City, N.A., v. Achtenberg,* No. 90-0950-CV-W-6, 1993 WL 476510 (W.D. Mo. Nov. 10, 1993) (Not reported in F.Supp), at *5 n.6 (finding that because the evidence had established that the debtors guaranteed a loan to an insolvent entity, the contingency no longer existed and the guaranty was fully payable);

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Conclusion

Most commercial real-estate mortgage lenders consider creditors' rights issues to be of paramount importance when negotiating the documentation for loan transactions. As highlighted in this paper, these issues often arise in connection with guarantees of a borrower-related individual or entity's obligations. Unfortunately, there is no simple solution that applies to every fact situation. The mortgage lender (and its counsel) should carefully analyze and evaluate the risks involved in a particular transaction. The lender must balance its desire to protect its rights in the real property collateral (and its remedies with respect to repayment of the mortgage indebtedness, including enforcement of guaranties) with the need to minimize the risk of potential challenges based on the violation of federal and state bankruptcy and insolvency statutes. By working closely with each other and sharing relevant information at each stage of the transaction, lenders and title insurers can often effect creative solutions to creditors' rights issues involving loan guaranties.

The "Burn Down" Guaranty: Yet Another Trap for the Unwary Lender?

By John C. Murray

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As recent case law demonstrates, real estate lawyers must pay special attention to the negotiation and documentation of limited and conditional guaranties

Introduction

On May 26, 1999, the Illinois Appellate Court issued its decision in *Bank of America National Trust and Savings. Association v. Schulson,* 305 Ill.App.3d 941, 714 N.E.2d 20 (1999), *modified and reh'g denied* (Jun. 30, 1999), *reh'g denied* (Sep. 9, 1999), *appeal denied*, 186 Ill. 2d 565, 723 N.W.2d 1161 (1999). The issue in this case involved the interpretation and enforceability of a "burn down" clause that appeared in separate but identical personal guaranties executed by the two individual owners of Lunan Family Restaurants Limited Partnership, an Illinois limited partnership ("Lunan"). The burn down provision automatically reduced the amount due under each of the guaranties by a fixed percentage as principal payments were made on a $13.5 million loan ("Loan") to Lunan by Bank of America ("Bank"). The Loan was secured by a mortgage recorded on October 2, 1991, as modified a First Amendment to Mortgage dated April 22, 1994 ("Mortgage"), as well as the owners' guaranties. The Mortgage covered, *inter alia*, Lunan's

leasehold interests in four family-style chain restaurants operated under a Shoney's Inc. franchise. The appellate court reversed the holding of the trial court, which had ruled that the "burn down" clause in each of the guaranties was ambiguous and would apply to the Bank's receipt of principal payments made after Lunan's default, including proceeds from the sale of the Loan collateral in Lunan's subsequent bankruptcy proceeding.

The "Burn Down" Clause

Each of the guaranty agreements repeatedly described the guaranty as "absolute" and "unconditional," and guaranteed "full and prompt payment, when due, whether by acceleration or otherwise, of all obligations." The right of recovery under each of the guaranties, however, was expressly limited to the payment of $3 million, as such sum might be reduced by the burn down provision contained in each guaranty. The "burn down" clause stated that the amount of the guaranty "shall be reduced by an amount equal to 36% of any principal payments made with respect to the Liabilities." The separate guaranty agreements did not provide for joint and several liability of the guarantors.

Lunan defaulted on the Loan at the end of 1993, and Lunan and the Bank subsequently entered into an Amended and Restated Loan and Security Agreement in March 1994. As part of this Loan restructuring, the Bank was paid $18,300 from the sale of equipment that constituted a portion of the Loan collateral. In accordance with the burn down clause, the Bank credited this amount against the unpaid principal balance due on the Loan, reducing the guaranties by 36% of this amount. In October 1994 Lunan filed a Chapter 11 bankruptcy proceeding, which both the Bank and the guarantors agreed constituted a default that triggered the guarantors' obligations under the guaranty agreements. In September 1996, the restaurants that constituted the Bank's security for the Loan were sold free and clear of all liens pursuant to § 363 of the Bankruptcy Code, with liens to attach to the sale proceeds. The bankruptcy judge ordered that approximately $8 million of the bankruptcy sale proceeds be applied to reduction of the unpaid principal of the Loan.

The Trial Court's Decision

On November 10, 1994, the Bank sent each of the guarantors a notice of Lunan's default under the Loan and demanded payment under the guaranties. On December 15, 1994, the Bank filed separate actions against each of the guarantors, seeking payment under the guaranties. The trial court later consolidated the two cases. The guarantors filed counterclaims seeking a declaration that they were each entitled to a reduction in the amount owed under the guaranties, in the amount of 36% of the amount of the proceeds received by the Bank from the bankruptcy sale of Lunan's restaurants. The counterclaims also alleged breach of contract by the Bank and a breach of the implied covenant of good faith and fair dealing (these claims were later voluntarily dismissed, without prejudice, by the guarantors). The Bank immediately moved for summary judgment, arguing that the burn down clause applied only to principal payments made before the guarantors' obligations became due on November 10, 1994. The trial court found that the burn down clause in each of the guaranties was "ambiguous." After reviewing the drafting history of

the clause and the evidence regarding negotiation of the clause by the parties, the trial court held that the parties intended the burn down provision to apply to payments made at "any" time by Lunan, including post-default payments received by the Bank as the result of the bankruptcy sale of Lunan's assets.

The Appellate Court's Ruling

The Bank argued strenuously on appeal that the trial court had erroneously construed the guaranties as guaranties of collection instead of payment. The Bank asserted that this interpretation was unjustified, because the language of the guaranties clearly provided that the Bank was entitled to collection under the guaranties immediately upon Lunan's default, notwithstanding the existence of the burn down provisions.

The appellate court agreed with the Bank's interpretation of the guaranty agreements. After reviewing the rules of construction applicable to contracts, as developed by case law, the court held that it was bound to give effect to the each of the guaranty agreements as a whole, i.e., each of the provisions of the agreements must be given effect and read in light of the other provisions. The court noted the distinction between guaranties of payment (requiring immediate payment of the debt if the debtor fails to pay) and guaranties of collection (requiring payment only if all efforts to collect against the debtor have first been exhausted). The court noted that the guarantors had abandoned their initial argument that the Bank was first required to attempt collection against Lunan before seeking recovery under the guaranties (although they still insisted that they were entitled to a reduction in their obligations under the burn down provision as the result of payments made at any time, including collection of the bankruptcy sale proceeds).

Both the Bank and the guarantors focused on the word "any" in the clause in each of the guaranty agreements that referred to "any principal payments made with respect to the liabilities." The Bank argued that the word "made" in this clause referred only to principal payments made by Lunan prior to Lunan's default and the Bank's demand for payment served on the guarantors. The guarantors, on the other hand, asserted that the word "any" meant that the burn down provision would apply to payments made at any time, whether before or after default by Lunan and notice to the guarantors. The guarantors also argued that the definition of "liabilities" in each of the guaranties included accelerated obligations, and thus the discount provided by the burn down provision should also apply to payments made on such accelerated obligations.

The appellate court agreed with the Bank's contention that the guarantors' interpretation of the burn down clause would contradict several other clauses in the guaranties, rendering them meaningless and ineffective. In particular, the court noted, the guaranties each contained numerous references to the "absolute" and "unconditional" nature of the promises and obligations of the guarantors. The court agreed with the Bank's argument that the "absolute" and "unconditional" language would be nullified under the guarantors' interpretation of the burn down clause. According to the court, "[w]hen a guaranty is 'absolute and unconditional,' the guaranteed party is not required to complete a foreclosure on the debtor's security before seeking payment

under the guaranty" (citations omitted). *Schulson*, 714 P.2d at 26. The court also noted that in addition to the words "absolute" and "unconditional," each of the guaranties contained a provision that allowed the Bank to "resort to the undersigned . . . for payment of any of the Liabilities, whether or not the Bank . . . shall have resorted to any property securing any of the liabilities or any obligation thereunder." *Id*.

The appellate court also noted that each of the guaranties stated that the Bank was entitled to "full and prompt payment" upon default by Lunan and/or notice of default to the guarantors. According to the court, this language would also become meaningless under the guarantors' interpretation. The court found that this triggering provision would be nullified if the due date could be extended, as occurred in this case, for a period of almost two years (i.e., until the date of distribution of the bankruptcy sale proceeds to the Bank). In support of this conclusion, the appellate court referred to its previous holding in *Telegraph Savings & Loan Association v. Guaranty Bank & Trust Company.*, 67 Ill. App. 3d 790, 385 N.E.2d 97 (1978), a case in which, the court stated, "the facts are very close to those before us." In *Telegraph*, the guarantors had also promised to "promptly and punctually" perform each of the covenants and conditions of the note, and to pay the first $35,000 of the principal debt obligation. The court in *Telegraph* noted that under Illinois law the undertaking of a guarantor is strictly construed, and is not to be enlarged or expanded beyond the precise terms of the guaranty agreement. However, the appellate court ruled in *Telegraph* that under the express terms of the guaranty the guarantors' obligations became due and owing immediately upon the borrower's default, and that only "voluntary" payments of principal – not payments received as the result of the subsequent foreclosure sale of the loan collateral - would release the guarantors from their obligations. To hold otherwise, the court in *Telegraph* stated, would make such guaranties meaningless and would permit guarantors always to wait until after a foreclosure sale to make payments to the lender.

The appellate court in *Schulson* further found that payments received as the result of a sale of the loan collateral, whether through a foreclosure sale or a bankruptcy sale, did not qualify as "principal payments" under the terms of the burn down clause. The court noted that each of the guaranties required "full and prompt payment" when Lunan's obligations became due without the Bank having to resort to the loan collateral. Therefore, according to the court, a ruling favoring the guarantors' interpretation of the clause would make the guaranties illusory because, as in *Telegraph, supra*, the amount actually owed by the guarantors could never be finally determined until the loan collateral had been sold.

The appellate court also rejected the guarantors' argument that "added language" prevails over printed forms. The court noted that each of the guaranties was a typed form with no added language, and found that in any event the contested language of the burn down provision could be "harmonized" with the other guaranty provisions. Similarly, the court also rejected the guarantors' argument that the burn down provision contained "specific" terms that should control over the "general" terms of the guaranties. The court found no evidence that the burn down provision was specific and that the other provisions referred to by the Bank were general, and held that the provisions could – and would - be construed as consistent so as to give effect to the entire agreement.

The appellate court next addressed the guarantors' assertion that the parol evidence rule should be "provisionally" considered to determine whether the burn down clause was ambiguous. The court acknowledged that in some circumstances, parol evidence might be provisionally introduced to determine whether a contract that appears clear on its face contains an ambiguity. The court further acknowledged that the parties had exchanged five drafts of the guaranties and that the burn down provision had been heavily negotiated. However, the court held that the provisional consideration of parol evidence would only be applicable where required to clarify the definition of specific terms of a contract, in order to determine an ambiguity. The court found that the language in the guaranties requiring prompt and punctual payment, and allowing the Bank to seek collection from the guarantors without first resorting to the collateral, was clear and unambiguous. The court therefore refused to permit the introduction or consideration of parol evidence by the guarantors.

For all of the foregoing reasons, the appellate court ruled that the guarantors' obligations were triggered upon Lunan's default and that the burn down clause in each of the guaranties applied only with respect to principal payments made at that time. The court specifically directed the trial court "to consider only principal payments made before Lunan filed bankruptcy in calculating the offset to which defendant was entitled." *Schulson*, 714 P.2d at 28.

Finally, the appellate court addressed the guarantors' contention that because the guaranties did not provide for joint and several liability, each guarantor should only be required to pay the expenses incurred with collection of his own guaranty. The court noted that although there was no joint and several liability, each guaranty provided that the guarantor would pay "all expenses" of enforcement. Therefore, the court held that each guarantor was liable for payment of the full amount of the Bank's collection expenses, but the Bank could only collect this amount once. The court further held that the guarantors could present evidence to the trial court to show that some expenses had been incurred with respect to collection of one of the guaranties but not the other.

Application to Limited and Conditional Guaranties

The lender is often willing to limit the amount guarantied by a third party in connection with a mortgage loan. Usually this is because the loan-to-value ratio at the commencement of the loan is sufficiently strong, or there is enough additional credit support or enhancement (e.g., additional collateral, a letter of credit, a master lease, or a defeasance arrangement), to permit only a limited or conditional guaranty of the underlying indebtedness. The lender may also be willing to condition the guarantor's liability upon the happening of a future event. As noted by the Illinois Appellate Court in *Lawndale Steel Company v. Appel*, 98 Ill. App. 3d 167, 170, 423 N.E.2d 957, 960 (1981), "[a] conditional guaranty requires the happening of some contingent event before the guarantor will be liable on his guaranty," while "[a]n absolute guaranty is an unconditional undertaking on the part of the guarantor that the person primarily obligated will pay or otherwise perform."

There are numerous types of limited and conditional guaranties, including the following: "burn down" or "burn off" guaranties; "top" guaranties (discussed below); "springing," "exploding" (or "vanishing"), "creeping," and "shrinking" guaranties; percentage guaranties; construction-completion guaranties; rental-achievement, lease-up, operating- deficit and "break even" guaranties; debt-service-coverage guaranties; dollar-limit or "maximum principal amount" guaranties; limited-time guaranties; "wrongful (or bad) acts" guaranties; "carry," "interest and carry," and "excess interest" guaranties (covering obligations other than repayment of the loan principal); loan-in-balance guaranties; and limited-amount liquidated-damages indemnity agreements. Also, some types of limited guaranties may exempt or exclude certain of the guarantor's (or guarantors') assets, or a portion of all of the guarantor's (or guarantors') assets, from coverage under the guaranty or, conversely, permit recourse only to a specified pool or portfolio of assets owned by the guarantor(s).

The nuances of each of these types of guaranties are beyond the scope of this article; however, each of these limited and conditional guaranties must be carefully drafted to avoid giving a court the opportunity to construe the limiting or conditional language against the lender and to further limit or even nullify the liability and obligations of the guarantor(s). Simple "buzz words" and phrases, such as "top X%," must be avoided.

A precise definition should accompany any words or phrases of limitation, and the nature and scope of the limitation should be clearly and comprehensively set forth in the guaranty agreement. The 1996 Restatement of the Law (Third) of Suretyship and Guaranty (American Law Institute) ("Restatement") provides definitions of terms commonly used in guaranty and surety agreements. It also provides guidelines for interpreting many of the terms and provisions commonly contained in such agreements. The Restatement does not have any specific definition of an "absolute" or an "unconditional" guaranty. This is probably because such language is deemed unnecessary; under § 8 of the Restatement, every guaranty is enforceable against the guarantor immediately upon default of the prime obligor unless the guaranty states otherwise, and the guaranty is effective without the obligee having to notify the guarantor of its acceptance. Many jurisdictions construe an "absolute and unconditional" guaranty as one that is a guaranty of payment and that is effective immediately upon the prime obligor's default This is contrasted with a guaranty of collection, which is enforceable against the guarantor only if (1) an execution of judgment against the prime obligor has been returned unsatisfied, or (2) the prime obligor is insolvent, or (3) the prime obligor cannot be served with process, or (4) it is otherwise apparent that payment cannot be obtained from the prime obligor. Restatement § 15(b).

"Top" Guaranties

Historically, lenders have had a difficult time drafting and enforcing guaranty language that obligated a guarantor to pay, e.g., the "top x%" of the loan amount. Such language, without more, is generally understood to mean that the guarantor is only liable for the difference between the loan balance and an amount set as a percentage of the original loan amount. This type of provision is often used by lenders to provide a "cushion" if the property decreases in value down

to the base level as established by the percentage amount of the original loan for which the guarantor is liable. The guarantor generally understands that its liability at any time will be limited to no more than the percentage amount it has agreed to, and that its liability will disappear when the loan balance has been paid down to a certain amount.

However, this type of limitation on a guarantor's liability, if not carefully and clearly negotiated and drafted, may be open to a claim of ambiguity with all of the potentially negative consequences that could result from a court's recharacterization of the clause. For example, the lender may contend (which contention is usually unsuccessful and will be vehemently contested by the guarantor) that the language should be construed so that the guarantor is always liable for an amount equal to the stated percentage of the original loan amount, regardless of the actual amount of the outstanding loan balance. Alternatively, the lender may seek an interpretation of the language (which can also be expected to be hotly contested by the guarantor) that would provide for the guarantor's liability to decrease (but never end until full payment) on a sliding scale, i.e., the guarantor would remain liable throughout the term of the loan but such liability would decrease pro rata to the extent the principal balance has been paid down by the borrower.

It is crucial when utilizing this type of guaranty to clearly define and clarify exactly what type of payments will qualify to reduce the guarantor's liability. For example, the proceeds from a foreclosure proceeding are generally applied first to the nonrecourse portion of the debt. If this were not the case, the "top" guaranty would be virtually worthless because the amount of foreclosure proceeds available would almost always be more than what would be required to satisfy the top portion of the debt. The lender expects a "last dollar" and not a "first dollar" guaranty, i.e., it anticipates that payments it receives from a foreclosure sale will first be applied against the unguaranteed (or nonrecourse) portion of the loan and that the guaranty will remain in effect until the loan has been paid in full. The language in the guaranty regarding the guarantor's "top" obligation should therefore provide that foreclosure (or bankruptcy) sale proceeds will first be applied to the nonrecourse portion of the debt and that, to the extent the proceeds are insufficient to fully pay the loan, the guarantor remains personally liable for the difference.

Case Law – Conditional and Limited Guaranties

Case law dealing specifically with the interpretation and enforceability of conditional and limited guaranties is not extensive. Lenders have prevailed in the majority of such cases, although the exact wording of the limiting or conditional clause is usually determinative of the guarantor's obligations. A recent decision by the Pennsylvania Superior Court held that a lender that has obtained the secured property at a foreclosure sale is not thereby precluded from seeking recovery of a deficiency from the guarantor under a limited guaranty, even where the fair market value of the property exceeded the amount of the guaranty. In *Confederation Life Insurance Company. v. Morrisville Properties, L.P.*, 715 A.2d 1147 (Pa. Super. 1998), the guarantor guaranteed a $2.7 million debt up to a maximum amount of $675,000. The court ruled that the lender could seek a deficiency from the guarantor, where it had not received the full balance of the debt from a foreclosure sale of the loan collateral and there was no potential for double recovery. The court stated that it was not bound by the holding of the Third Circuit Court of Appeals in *Federal Home*

Loan Mortgage Corporation v. Arrott Associates, 60 F.3d 1037 (3d Cir. 1995), which, the court in *Confederation Life* ruled, had misinterpreted Pennsylvania's Deficiency Judgment Act (Pa. St. 42 Pa.C.S.A. § 8103) in holding that the guarantor in that case was released because the fair market value of the property exceeded the amount of the guaranty.

The court in *Confederation Life* found that the Third Circuit's reasoning would produce an "absurd and unreasonable" result, i.e., if the lender had pursued a personal action against the borrowers first and then commenced the foreclosure action, it would have been able to collect the entire debt. Furthermore, if the borrowers had been liable for the entire amount of the debt, a deficiency judgment could have been obtained against them for the difference between the value of the property and the amount of the debt, which the lender would then be able to collect in order to be made whole. In contrast, the court noted, if the borrowers were liable for only a portion of the debt, their liability would be discharged if the amount of their liability was less than the fair market value of the secured property – even though the lender had suffered a substantial loss. The court in *Confederation Life* agreed with the holding of the trial court that "the phrase 'to the extent of the fair market value' simply means that 'the creditor's judgment against the debtor is reduced by the fair market value of the property purchased by the creditor rather than by the actual sale price of the property.'" *Confederation Life*, 715 A.2d at 1152 (citing Trial Court opinion at 12-14). The court also rejected the argument of the guarantor that the lender's receipt of the foreclosed property by means of the foreclosure sale was equivalent to a payment by the borrower or guarantor. The court quoted the language in the guaranty that stated the guarantor's obligations would be reduced only "[a]s Borrower makes regular monthly payments of principal on the Loan." The court held that because the lender had already received the property, which was insufficient to pay the debt, it was free to seek recovery against the additional security provided by the guaranty. Interestingly, Pennsylvania's Deficiency Judgment Act was amended in several respects, effective December 21, 1998. One of the amendments was the addition of a section (Pa. St. 42 Pa.C.S.A. § 8103(f)) specifically intended to overturn the decision in *Arrott*, *supra*. This new section applies in the case of a limited guaranty or partial recourse obligation where "the judgment creditor is a nonconsumer judgment creditor." After a foreclosure judgment has been obtained by a qualifying creditor, the new section provides that the fair market value of the property (as determined by the court) will be applied first to discharge all liability for the nonrecourse portion of the loan, or the portion of the obligation that was not guaranteed, before any portion of such value is applied to discharge any liability for the recourse portion of the obligation, or the portion of such obligation which is guaranteed.

As demonstrated by the holdings in *Confederation Life and Arrott, supra,* lenders and their counsel who seek to obtain loan guaranties in states with loan-deficiency statutes should determine, at the earliest opportunity, whether the protections of such laws are available to guarantors as well as borrowers. Lenders should also determine whether, in the event such statutes cover guarantors, the defenses provided therein may be waived. In *Connecticut General Life Insurance Company v. Punia*, 884 F.Supp. 148, 151-53 (D.N.J. 1995), the guaranty provided that the guarantors would only be liable for the top $3 million of the $11 million mortgage loan, and that their obligations would be reduced as the result of application of payments on the loan principal from "whatever source." The court held that the guarantors were entitled under a New

Jersey statute to have their obligations reduced by the fair market value of the mortgaged property, and not just by the $100 that the mortgagee successfully bid at the foreclosure sale. *See also* Thomas G. Roberts, *Guarantors of Real Estate Secured Loans – Are They Entitled to a Fair Value Defense?* Tab 14 (April 4-5 1997) (American College of Real Estate Lawyers Annual Meeting on Finance Topics); Ira J. Waldman, *Guarantor Rights Under Borrower Antideficiency Statutes: The Guarantor/Borrower Distinction – Should Guarantors Be Protected by Antideficiency Laws?* 1995 American Bar Association Annual Meeting, Getting the Dirt on Distressed Real Estate – Hot Tips and Workshop (Real Property, Probate and Trust Law Section).

Other cases have held, as in *Confederation Life*, *supra,* that where a loan is secured by property (or "hard collateral") as well as a partial guaranty for the top or "first portion" of the debt, the lender may first apply the proceeds from a foreclosure sale to the unguaranteed portion of the debt. In *University Savings Association v. Miller*, 786 S.W.2d 461, 463 (Tex. App. – Houston [14th Dist.]), *writ denied*, the guarantor guaranteed "the first or top 10% of all sums owing on the debt." The court rejected the guarantor's contention that he should be relieved of all liability because the foreclosure proceeds from the sale of the mortgaged property reduced the principal balance of the loan by more than the 10% that he had guaranteed. The court noted that the guaranty was unconditional and did not require that the mortgagee first resort to the loan collateral before seeking collection under the guaranty. The court further noted that the guaranty contained "another provision allowing [the mortgagee] to apply the security the unguaranteed portion of the debt before applying it to the indebtedness guaranteed by [the guarantor]." *Id.* at 463. The court therefore held that the mortgagee's application of the foreclosure sale proceeds to the unguaranteed portion of the debt did not terminate the guaranty.

See also Telegraph, supra, 67 Ill. App 3d at 796, 385 N.E.2d at102 ("[a]pplying the foreclosure sale proceeds as payments on the loan would render the guaranty taken as additional security illusory and meaningless"); *Warnaco, Inc. v. Farkas*, 872 F.2d 539, 543 (2nd Cir. 1989) (holding that the phrase "20% of the amount due under this Note" was "clearly a guaranty of the percentage of the total amount," thus the guarantors were liable for the full guaranteed portion of the original $750,000 amount of the note, regardless of the $140,000 paid by the debtor before default); *Alpha Financial Associates v. Dann*, 18 Misc.2d 73, 75-76 186 N.Y.S. 2d 554, 557 (1959) (holding that where the guarantor had guaranteed the first $18,000 of the debt, foreclosure sale proceeds were not received on account of the loan but on account of the property, and could be applied by the lender to the unguaranteed portion of the loan); *Security Co-operative Bank v. Corcoran*, 298 Mass. 156, 157-58, 10 N.E.2d 57, 57-58 (1937) (ruling that where the guarantor guaranteed payment of the debt of $8,000 until $1600 was paid on principal and the debtor defaulted before the loan was reduced by such amount, the guarantor was liable for the entire amount of the outstanding debt remaining after the mortgagee credited the net foreclosure proceeds); *DuQuoin State Bank v. Daulby*, 115 Ill.App.3d 183, 186, 450 N.E.2d 347, 349 (1983) ("[t]o hold that the [guarantors'] liability was discharged by the amount paid by the bank at the foreclosure sale would not effectuate the intent of the parties"); *Crown Life Insurance Company. v. LaBonte*, 330 N.W.2d 201, 206 (Wis. Sup. Ct. 1983) (holding that where the guaranty required payment by the guarantor of the first $45,000 of the debt, only "voluntary" payments would discharge the guarantor's liability, and the subsequent sale of the secured property and application

of the proceeds would not extinguish this liability where the entire debt had not been satisfied); *Lindell Square Ltd. Partnership v. Savers Federal Savings and Loan Association*, 27 Ark.App.66, 77, 766 S.W.2d 41, 47 (1989) (ruling that the guarantors' liability under a bond guaranty, which limited their liability to a stated percentage of the amount due under the note, would be computed as a percentage of the amount due at the time of default, rather than any deficiency remaining after application of the foreclosure sale proceeds); *Preston Ridge Financial Services Corporation v. Tyler*, 796 S.W.2d 772, 779-80 (Tex. App. – Dallas 1990), *writ denied* (holding that, where the guarantor promised to pay "when due" amount by which the total principal outstanding exceeded $735,000, the guarantor's liability was fixed upon the principal debtor's default, even though the lender later collected $735,000 at foreclosure sale); *Moore v. Bank Midwest, N.A.*, 2001 Tex.App. LEXIS 1027 (Tex.App. – Houston 2001) at *17 (ruling that where note and mortgage contained language that mortgagor would be personally liable for payment of 20% of outstanding principal balance and accrued interest thereon "and all other sums due thereunder" owing on maturity date of note "whether by acceleration or otherwise," mortgagee could apply 20% limitation to total amount due on loan at maturity and was not limited to percentage of deficiency amount, and mortgagee was entitled to collect entire amount of deficiency after foreclosure sale because such amount was less than maximum amount of mortgagor's agreed liability); *Martin v. First Republic Bank*, 799 S.W.2d 482, 486 (Tex. App. – Fort Worth 1990), *writ denied* ("[t]he bank's legal right to seek judgment against appellants pursuant to the guaranties without either foreclosing on the real property or joining the joint venture in the lawsuit, is clear upon reading the terms of the guaranties"); *SEI Business Systems, Inc. v. Bank One Texas*, 803 S.W.2d 838, 840 (Tex. App. – Dallas 1991), *writ denied* (holding that the guaranty explicitly relieved the lender from any duty to sell all the collateral before suing the guarantor). *See also* Philip D. Weller, *Credit Enhancement: Guaranty Agreements,* 5 The ACREL Papers 93, 94-98 (1992); Robert E. Wilson, *Guaranty Agreements: Negotiated Exceptions and Limitations to Liability*, American Bar Association, Section of Real Property, Probate and Trust Law Newsletter (1989) at 63. An example of a "top" percentage guaranty, as set forth in Mr. Wilson's article, is reprinted (with permission) as attached **Appendix A**.

Not all courts have upheld lenders' interpretations of limited and conditional guaranties. In *Boatmen's First National Bank of Kansas City v. P.P.C. Inc.*, 927 F.2d 394, 3 (8th Cir. 1991), the court held that a guaranty "limited to 20% of the outstanding borrowing" was ambiguous. The guaranty also contained a further limitation that the guaranty only applied to loans "secured by accounts receivable and inventory." The court determined that use of the phrase "outstanding borrowing" instead of the phrase "amount due" commonly inserted in guaranties, created an ambiguity . The court found that it was unclear whether the lender was first required to proceed against the loan collateral, notwithstanding that another provision of the guaranty provided that the lender could proceed against the guarantor "without first taking steps against . . . any collateral that it may hold." The court permitted the introduction of parol evidence to determine the intent of the parties. The court also ruled that the lender owed a good faith duty to the guarantor to act with a reasonable degree of care with respect to collateral and to promptly dispose of it to ensure collection.

Courts have also have imposed certain obligations and limitations on lenders with respect to the enforceability and collection of limited and conditional guaranties (often resulting from ambiguities and deficiencies in the language describing the limited or conditional nature of the guaranty). This is especially true when determining whether lenders must first apply the proceeds of the sale of the loan collateral to the indebtedness before seeking recovery against the guarantor(s). *See, e.g., Groh v. B.F. Saul Real Estate Investment Trust,* 224 Va. 156, 159, 294 S.E.2d 156, 861 (Vir. 1982) (holding that, based on language in a provision limiting the guarantor's liability to any indebtedness above $3,100,000, the lender was obligated to apply foreclosure proceeds against the debt before seeking recourse under the guaranty; and finding that the guarantors were released from liability because application of the proceeds reduced the debt below the guaranty threshold amount); *Warnaco, Inc. v. Farkas, supra,* 872 F.2d at 545 ("[a] creditor holding valuable collateral has no right to hold valuable collateral and to collect on the full amount of the debt secured by the collateral"); *Bankeast v. Michalenoick*, 138 N.H. 367, 370-71, 639 A.2d 272, 274 (N.H. Sup. Ct. 1994) (under a guaranty providing that it would be reduced to the extent of "any" principal paydown, the lender was required to reduce the guarantor's obligation by the amount of the foreclosure sale proceeds); T.*O. Stanley Boot Co., Inc. v. Bank of El Paso*, 847 S.W.2d 218, 223 (Tex. 1992), *rehearing of cause overruled* (holding that although the guarantors could not assert the U.C.C. statutory defense of impairment of collateral, they were entitled to assert the common law defense of impairment of collateral; the court noted that although "the parties to a guaranty may normally waive such a defense," in this case the lender had failed to plead waiver as an affirmative defense); *Long v. NCNB-Texas National Bank*, 882 S.W.2d 861, 867-69 (Tex. App. – Corpus Christi 1994) (ruling that although guarantors of a note secured by real estate are not generally entitled to notice of foreclosure sale and are not owed duty of good faith by lender, the lender has a common law duty to use ordinary care in disposing of the security unless the guaranty provides otherwise); *Rabinowitz v. Cadle Co. II, Inc.*, 993 S.W.2d 796, 799-800 (Tex. App. – Dallas 1999) (holding that under a Texas statute, "guarantors are entitled, after default of the primary obligor and repossession of the collateral by the lender, to the commercially reasonable disposition of the collateral securing the transaction for which the guaranty is given"); *cf. Federal Deposit Insurance Corporation v. Coleman*, 795 S.W.2d 706, 709 (Tex. 1990) (rejecting the guarantors' assertion that the lender did not sell the collateral "soon enough," the court held that "the relationship between a creditor and a guarantor does not ordinarily import a duty of good faith"; in any event, the guaranties expressly waived any obligation of "the creditor from seeking its debt from the collateral at all").

Another issue that arises in connection with the enforcement of limited and conditional guaranties is whether, and to what extent, interest accruals are covered. *See, e.g., Savers Federal Savings and Loan Association v. Amberly Huntsville, Ltd.*, 934 F.2d 1201, 1210-11 (11th Cir. 1991) (remanding the case to the trial court for determination of whether, after the occurrence of a specified "limitation date," the agreement of the guarantor to pay the amount outstanding from time to time by which the unpaid principal balance of note exceeded $5,880,000 limited the guarantor's liability to payments of only principal, and not interest); *Tulane Hotel Investors Corporation. v. First National Bank*, 1987 WL 15651 (E.D.La.) (not reported in F.Supp.) at *4 (holding that, based on language in the guaranty limiting the guarantors' liability on $10 million and $500,000 "master promissory notes" to $100,000, the guarantors were not obligated to pay

interest and attorneys' fees incurred in collection of principal amounts in excess of $100,000); *cf. Miller v. University Savings Association*, 858 S.W.2d 33 (Tex. App. – Houston [14th Dist] 1993), *writ denied* (finding that the obligation of the guarantors to pay the first or top 10% of the indebtedness evidenced by the note, "including interest and attorneys' fees as provided for therein," obligated the guarantors to pay interest through the foreclosure sale).

The limiting language in the guaranty should also address the extent and amount of reduction of the guarantor's liability as the result of the application of proceeds received from the following additional sources: prepayment premiums; condemnation and insurance loss; collection of rents in default; recovery from other guarantors and indemnitors; and the sale of personal property and other non-real estate collateral. Furthermore, as highlighted by the *Schulson* decision, *supra*, determination of exactly when the guarantor's liability is triggered is crucial. Does the guarantor become responsible for payment of the debt: (1) on the date that the borrower defaults under the note, mortgage, or loan agreement? (2) on the date that notice of such default is delivered to the guarantor? (3) on the date of final disbursement of foreclosure or bankruptcy sale proceeds?, or (4) upon the exhaustion of all other remedies available against the borrower and/or other loan collateral or guarantors? An example of a comprehensive guaranty, with limitation of the guarantors' obligations to a specified dollar amount and a "springing" obligation to pay only upon the occurrence of certain future events, is attached as **Appendix B**.

Application of the "*DePrizio* Doctrine" to Limited Guaranties

Lenders should also be cognizant of bankruptcy issues that may arise in connection with mortgage loans additionally secured by limited or conditional guaranties. Section 202 of the Bankruptcy Reform Act of 1994, Pub. L. No. 103-394, 108 Stat. 4106, 4121 (1994) ("1994 Reform Act"), amended § 550 of the Bankruptcy Code ("Code"). The amendment to § 550 was intended to effectively overrule *Levit v. Ingersoll Rand Finance Corporation (In re V.N. DePrizio Construction Co.*), 874 F.2d 1186 (7th Cir. 1989), and its progeny. Under *DePrizio*, courts extended the preference avoidance period from ninety days to a full year for noninsider creditors when the transfers in question nevertheless benefited an insider. In particular, *DePrizio* permitted a bankruptcy trustee to recover preferential payments, under §§ 547 and 550 of the Code, consisting of loan payments made to noninsider lenders during this extended one-year preference period when the debt was guaranteed by insiders (the controlling shareholders) of the debtor. (An insider is one who is a principal of, or related to, or affiliated with the debtor. 11 U.S.C. § 101(31)). The Seventh Circuit in *DePrizio* reasoned that even though the preferential payments were not made to the insiders, they were for the benefit of the insider creditors, because each payment made to the lenders reduced, on a dollar-for-dollar basis, the liability of the guarantors to the lenders. The insider guarantor is a "creditor" of the borrower by virtue of its subrogation rights against the borrower, which arise at the time it makes payments under the guaranty.

Section 202 of the 1994 Reform Act expressly intended to overrule *DePrizio* by stating that payments to a noninsider lender may only be recovered if made during the ninety-day period following such payments. Section 202 added the following subsection (c) to § 550 of the Bankruptcy Code:

If a transfer made between 90 days and one year before the filing of the petition --
(1) is avoided under Section 547(b) of this title; and
(2) was made for the benefit of a creditor that at the time of such transfer was an insider;
the trustee may not recover under subsection (a) from a transferee that is not an insider.

The relevant legislative history with respect to this section states that:

> This section overrules the *DePrizio* line of cases and clarifies that non-insider transferees should not be subject to the preference provisions of the Bankruptcy Code beyond the 90-day statutory period.

140 Cong. Rec. H10767 (daily ed. October 4, 1994).

Every court of appeals to consider the application of the *DePrizio* doctrine (prior to the enactment of the 1994 Reform Act) has adopted it. *See Official Unsecured Creditors Committee. v. United States National Bank (In re Suffola, Inc.)*, 2 F.3d 977 (9th Cir. 1993) *Galloway v. First Alabama Bank (In re Wesley Indus., Inc.)*, 30 F.3d 1438 (11th Cir. 1994); *Southmark Corporation v. Southmark Personal Storage, Inc.)*, 993 F.2d 117 (5th Cir. 1993); *In re C-L Cartage Co.*, 899 F.2d 1490 (6th Cir. 1990); *Manufacturers Hanover Leasing Corporation v. Lowrey (In re Robinson Bros. Drilling, Inc.)*, 892 F.2d 850 (10th Cir. 1989); *In re Erin Food Services*, 980 F.2d 792, 798-99 (1st Cir. 1992); *T-B Westex Foods, Inc. v.* FDIC, 950 F.2d 1187 (5th Cir. 1992); *Ray v. City Bank & Trust Co.*, 899 F.2d 1490 (6th Cir. 1990).

In a recent bankruptcy decision that considered the *DePrizio* doctrine, *O'Neill v. Orix Credit Alliance, Inc. (In re Northeastern Contracting, Inc.)*, 233 B.R. 15 (D.Conn 1999), the court held that the doctrine would also be applied in the Second Circuit, in a case filed prior to the 1994 Reform Act, to the extent that the debtor's payments to a non-insider creditor benefited an insider-guarantor. The court stated that "the code that existed prior to the [1994 Bankruptcy Code] amendments lent itself to the interpretation enunciated in *DePrizio." Id*. at 19. However, the court also stated that "the *DePrizio* line of cases was effectively overruled by the 1994 congressional amendments to the Bankruptcy Act [*sic*]." *Id.* at 17 n. 2. All of the federal circuit court cases upholding the *DePrizio* doctrine were decided prior to the passage of the 1994 Reform Act (or, in the case of *Northeastern*, applied to a case that was filed prior to October 22, 1994, the effective date of the 1994 Reform Act). The court in *Northeastern* noted that other courts in the Second Circuit have criticized, questioned, or rejected the *DePrizio* doctrine, often based on the argument that the doctrine unfairly penalizes diligent creditors and may have a "chilling effect" on the ability of a company to secure favorable corporate credit terms by offering guarantees from insiders as additional security. *See In re Frank Santora Equipment Corporation*, 213 B.R 420, 424 (E.D.N.Y. 1992); *In re Wedtech Corporation*, 187 B.R. 105, 110 (S.D.N.Y. 1995); *Pereira v. Lehigh Savings Bank (In re Artha Management, Inc.).* 174 B.R. 671, 677 (Bankr. S.D.N.Y. 1994); *Weiskopf v. New York Job Development Authority*, 145 B.R. 3, 4 (Bankr. N.D.N.Y. 1992).

However, in another recent bankruptcy court decision, *Roost v. Associates Home Equity Servs., Inc. (In re Williams),* 234 B.R. 801 (Bankr. D.Or. 1999), the lender argued that because the defendant was a non-insider creditor, the 1994 Reform Act amendment to § 550 barred any recovery by the trustee. The trustee conceded that it could not "recover" any transferred property, but argued that no recovery was necessary in this case because the debtor's interest in the property (a mobile home) became property of the bankruptcy estate upon the filing of the debtor's bankruptcy petition. Therefore, the trustee asserted, there was nothing to recover and no need to seek the remedies provided by § 550 of the Code. The trustee maintained that the security interest of the defendant had been avoided pursuant to § 547(b) of the Code, and that such avoidance provides a remedy separate and distinct from the right to "recover" transferred property under § 550. The trustee also argued that under § 551 of the Code, the avoided lien was preserved for the benefit of all creditors of the estate. This was not, the trustee noted, a situation where the property had been transferred to the creditor or a third party prior to the bankruptcy filing, in which event the trustee's remedy would be to seek recovery under § 550. The trustee also pointed out that the debtor and his wife were in possession of the mobile home at the time of the filing of the debtor's bankruptcy petition, and had continuously remained in possession of the property.

The court noted that "[t]his appears to be a case of first impression in this District." *Id.* at 803. The court also acknowledged that there is a split of authority among commentators (and among the few bankruptcy courts that have dealt with the issue) as to whether § 547 of the Code provides a separate remedy from the right to "recover" under § 550. However, based on its review of the legislative history of § 550 (including the 1994 Reform Act), and the fact that Congress saw fit only to amend § 550 of the Code and not § 547(c), the court in *Williams* the court agreed with the trustee's position. *See also Eisen v. Allied Bancshares Mortgage Corp. (In re Priest)*, 2000 Bankr.LEXIS 669 at * 9 (citing *Williams* with approval and stating that "[a] straightforward reading of the statutory language leads to the conclusion that § 544(a) avoidance and § 550 recovery are independent statutory remedies, which means that the Trustee may avoid [the mortgagee's] lien without necessarily recovering it").

But see Black & White Cattle Co. v. Granada Cattle Services, Inc. (In re Black & White Catte), 783 F.2d 1454, 1461-62 (9th Cir. 1985) (holding that, with respect to the issue of whether the investors-creditors' title to cattle in possession of the debtors, but owned by the investors-creditors, was avoidable under § 550(d) [now § 550(e) of the Code] and not § 550(c), § 550 applies even when the plaintiff is merely seeking to avoid a transfer under § 547 and not to recover money or property under § 550); *Helbling v. Krueger (In re Krueger)*, 2000 Bankr. LEXIS 723 at *14-18 (Bankr. N.D. Ohio June 30, 2000) (criticizing the holding of the *Williams* court and stating that "it strains credulity that either commercial lenders, or Congress acting at their behest to limit recovery of insider preference to insiders, would limit 550(c)'s protection to possessory transfers").

The decision in *Williams* confirms the belief of several commentators, as set forth in articles published after the enactment of the 1994 Reform Act, that negative consequences for lenders may still exist notwithstanding the addition of subsection (c) to § 550 of the Code. These commentators have expressed their concern that § 202 of the 1994 Reform Act eliminated only the right to *recover* the preference and that the preference may still be avoidable, notwithstanding the clear intention of Congress to overrule the *DePrizio* line of cases and to protect noninsider transferees for transfers received more than ninety days prior to the bankruptcy filing. *See* Robert Millner, *Is DePrizio Dead . . . or Just Wounded? Lien Avoidance as a Post-Reform Act Remedy for Trilateral Preferences*, Lender Liability News (LRP Publications), May 19, 1995, at 12-13; Lawrence Ponoroff, *Now You See It, Now You Don't: And Unceremonious Encore for Two-Transfer Thinking in the Analysis of Indirect Preferences*, 69 Am. Bankr. L.J. 203 (1995); Richard C. Josephson, *The* DePrizio *Override: Don't Kiss Those Waivers Goodbye Yet*, 4 Bus. L. Today 40 (1994) (cited by the court in *Williams* in support of its holding); Adam A. Lewis, *Did It or Didn't It? The* DePrizio *Dilemma*, 10 Am. Bankr. Inst. J. 20 (1995); *Bankruptcy: Avoidance of Insider Preferences*, 29-SEP Real Est. L.Rep. 1 (1999); John C. Murray, *DePrizio Lives (in a Mobile Home in Oregon)*, 18-Oct. Am. Bankr. Inst. J. 14 (1999).

The *Williams* decision has prompted Congress to close the "loophole" in the existing language of §§ 547 and 550 of the Code exposed by the court in this case. Although the intention of Congress, in enacting § 202 of the 1994 Reform Act, may have been to prevent recovery of all payments to non-insider creditors outside of the 90-day preference period, then Congress has recognized the need to specifically amend § 547 of the Code. As the court in *Williams* noted, "the most effective method would have been to add another defense or exception to avoidance in § 547(c)." *Williams*, *supra*, 234 B.R. at 805.

Both H.R. 33 and S. 420, which contain the Code amendments expected to be signed into law by President Bush sometime in 2001, contain a provision (sec. 1213 in both bills) overruling the *DePrizio* doctrine. This provision would apply to any case that is pending or commenced after the date of enactment. This new provision (which has not generated any debate) specifically amends sec. 547 of the Bankruptcy Code (as opposed to sec. 550 of the Bankruptcy Code, which was amended by the Bankruptcy Reform Act of 1994 with the misplaced intention of resolving the *DePrizio* issue). This specific amendment (and the drafters' brief comment) state as follows:

SEC. 1213. PREFERENCES.

(a) IN GENERAL- Section 547 of title 11, United States Code, as amended by this Act, is amended--
(1) in subsection (b), by striking `subsection (c)' and inserting `subsections (c) and (i)'; and
(2) by adding at the end the following:
`(i) If the trustee avoids under subsection (b) a transfer made between 90 days and 1 year before the date of the filing of the petition, by the debtor to an entity that is not an insider for the benefit of a creditor that is an insider, such transfer shall be considered to be avoided under this section only with respect to the creditor that is an insider.'.

(b) APPLICABILITY- The amendments made by this section shall apply to any case that is pending or commenced on or after the date of enactment of this Act.

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(Sec. 1213) Revises guidelines governing preferences to provide that, if the trustee avoids a security interest given between 90 days and one year before the date of the filing of the petition, by the debtor to a non-insider for the benefit of a creditor that is an insider, then such security interest shall be considered to be avoided only with respect to the insider creditor.

Until the proposed 2001 bankruptcy amendments (which should eliminate the *DePrizio* issue once and for all) are enacted into law, it may be prudent for lenders to continue to insist that guarantees of mortgage loans by insider guarantors contain language waiving any subrogation rights against the mortgagor. This strategy was commonly utilized after the holding in *DePrizio*, and prior to (and, by cautious lawyers, after) the enactment of the 1994 Reform Act. The theory behind the addition of such language in the guaranty is that the guarantor is thereby not a creditor at all because of the waiver of his or her right to collect against the mortgagor in the event the guarantor is subsequently required to pay the debt to the mortgagee. The bankruptcy court in *Northeastern*, *supra*, concurred with this reasoning, finding that one of the creditors had waived his subrogation rights and was therefore not a creditor, but holding that another guarantor was a creditor for purposes of the *DePrizio* doctrine because he had merely postponed (and not waived) his claims until all noninsider creditors were paid in full.

Assuming that (as the bankruptcy court held in *Williams, supra*) the *DePrizio* doctrine may still apply with respect to loans guaranteed by insiders, the lender may nonetheless be able to argue that, with respect to a partial guaranty, the doctrine (and therefore the extended preference period) does not apply. As one commentator has explained:

> Consider the following hypothetical. Borrower executes a promissory note for $1,000,000. The borrower's parent corporation guarantees repayment of only $700,000. When the borrower files its bankruptcy petition, the unpaid principal is $800,000 (with the $200,000 paid more than ninety days before but within one year of the filing date of the petition). If the bankruptcy trustee attempts to recover the $200,000 from the lender, may the lender successfully argue that the parent guarantor never received a benefit from the $200,000 payment (because its exposure under the guaranty did not decrease) and thus the preference period is only 90 days (precluding disgorgement of the $200,000 received outside the 90-day period)?

(citations omitted). Timothy R. Zinnecker, *Lawyers Who Draft and Negotiate Guaranties (and the Clients Who Love Them)*, 35 S. Tex. L. Rev. 387, 416 n.50 (1994).

In *Travelers Insurance Company v. Cambridge Meridian Group, Inc. (In re Erin Food Services, Inc.)*, 980 F.2d 792, 800-01 (1st Cir. 1992), the Fifth Circuit confronted the "trilateral preference" problem in connection with a limited guaranty. The insider guarantor in this case had guaranteed a debt of $61.7 million. This nonrecourse guaranty was secured by collateral with a value of $19.35 million at the time of the involuntary Chapter 11 bankruptcy petition filed against the borrower. The value of the collateral therefore established a "ceiling" on the guarantor's liability. The alleged preferential transfer consisted of payments of $2.08 million of interest installment payments made on the loan within the year prior to the bankruptcy filing. The court held that the longer one-year preference period was not applicable because there was no quantifiable reduction in the insider guarantor's contingent claim against the borrower's bankruptcy estate to the detriment of other creditors. The court reasoned: (1) that the guarantor's exposure ($19.35 million) was the same both before and after the transfer; (2) that no evidence was presented to suggest that the value of the pledged collateral fluctuated; and (3) that therefore the guarantor did not benefit from the challenged transfer.

Similarly, in *Cannon Ball Industries, Inc. v. Sequa Corporation (In re Cannon Ball Indus., Inc.*), 155 B.R. 177, 179-80 (N.D.Ill. 1993), the court held that the one-year extended preference period did not apply where the borrower's payments had not reduced the underlying debt obligation below the amount of the insider's guaranty. The corporate borrower had executed a promissory note in the principal amount of $750,000, which was guaranteed, in the amount of $150,000, by three of the corporation's shareholders. Within the year prior to the borrower's Chapter 11 bankruptcy filing, the borrower had made loan payments totaling almost $44,000. At the time of the bankruptcy filing, $400,000 remained due on the note. The court stated that "[t]he guarantor's liability exposure remains the same whether the debt is one million dollars more than the guaranty or one dollar more. If the debtor defaults in either case, the guarantor is on the hook." *Id.* at 179. The court, citing *Erin, supra,* with approval, and noting that the trustee had the burden of offering evidence of the purported benefit to the guarantor, also noted that "this court does not consider the term 'benefit' in section 547(b) to embrace potential benefit." *Id.* at 180.

Conclusion

Although the Bank ultimately prevailed at the appellate level, the *Schulson* case, *supra*, clearly highlights the risks and dangers to lenders in taking limited guaranties from third parties as additional security for mortgage loans. Even though each of the guaranties clearly stated that it was a "guaranty of payment," the guarantors managed to convince the trial court that the "ambiguity" of the burn down language had somehow converted the documents into guarantees of collection. Unless carefully and comprehensively drafted, a percentage or "burn down" guaranty, which provides for guarantor liability for a stated percentage of the debt, presents an especially attractive target for a challenge based on its "ambiguous" meaning. To what amount does the percentage apply – to the net amount after collateral recovery or to all amounts due and owing at the time of the borrower's default ? Do regular principal payments received by the lender reduce pro-rata the percentage amount owed by the guarantor(s)? At what time is the amount determined – upon the borrower's default, upon notice to the guarantor(s) of the acceleration of the debt, or upon collection of all proceeds available from the loan collateral, whether by foreclosure, bankruptcy or other collateral sale? What about interest on the guarantor's unpaid share of the

principal balance of the loan? What about the lender's share of attorneys' fees and other expenses of collection? What about the order, proportions and priority of the application of amounts received by the lender? What about the application of proceeds received from personal property and other ancillary forms of collateral? If there is more than one guarantor, is the total liability joint and several? Should the guaranty contain a "springback" or "clawback" provision that provides for reinstatement of the guarantor's (or guarantors') obligations if changing facts subsequently eliminate the condition or occurrence upon which the guaranty was initially released? All of these questions, and more, should be addressed and answered to the satisfaction of the lender, and covered (to the extent possible) in the provision(s) of the guaranty limiting or conditioning the liability of the guarantor(s).

APPENDIX A

Guaranty of Top Percentage

The term "Guaranteed Indebtedness" means… (i) the top ten percent (10%) of all principal funded by Lender under the Loan Agreement; (ii) the top ten percent (10%) of all interest accruing on the principal balance of the Loan (including, if applicable, interest at the Default Rate); and (iii) the top ten percent (10%) of all Lender Expenses. All payments (whether by regular monthly installments, prepayments, foreclosure proceeds and/or recoveries from other Guarantors) made on the Loan shall be credited, to the extent of the amount thereof, in the following manner:

(i) first, to the payment of that portion of the Lender Expenses as to which Guarantor is personally liable;

(ii) second, to the payment of that portion of the Lender Expenses as to which Guarantor is not personally liable;

(iii) third, to that portion of accrued but unpaid interest as to which Guarantor is personally liable;

(iv) fourth, to that portion of accrued but unpaid interest as to which Guarantor is not personally liable;

(v) fifth, to that portion of the principal balance of the Loan as to which Guarantor is personally liable; and

(vi) sixth, to that portion of the principal balance of the Loan as to which Guarantor is not personally liable.

APPENDIX B

Guaranty

1. The Guaranty. FOR VALUE RECEIVED and in consideration of advances made or to be made, or credit given or to be given, or other financial accommodation from time to time afforded or to be afforded to ____________________, a limited partnership organized and operated under the laws of the state of _______________ (the "Beneficiary") or to _______________ NATIONAL BANK AND TRUST COMPANY OF _______________ ("Trustee"), not personally but as Trustee under Trust Agreement dated __________, 199__ and known as Trust No. __________ (herein, Beneficiary and Trustee, individually and collectively, jointly and severally, together with the successors and assigns of each of them, are sometimes called "Debtor"), by ____________________, its successor or successors, immediate or remote, by merger, consolidation, sale of a major portion of its assets or otherwise (all of which are hereunder called "Lender"), and in consideration of Lender entering into the Settlement Agreement (defined hereinafter), the undersigned, ____________________ and ____________________ (individually, a "Guarantor," and collectively, "Guarantors"), jointly and severally hereby unconditionally guaranty (subject to the limitations set forth in Section 2 hereof) the full and prompt payment and performance when due (whether by acceleration or otherwise) to Lender of the Obligations (defined below). For all purposes of this Guaranty ("Guaranty"), the term "Obligations" shall mean and include all obligations and indebtedness (including, without limitation, all principal, Basic Interest, Additional Interest, costs, fees and expenses) of Debtor to Lender of any kind whatsoever, howsoever created, arising or evidenced, whether direct or indirect, absolute or contingent, now or hereafter existing, or due or to become due, under or with respect to any or all of the following:

a. An Amended and Restated Mortgage Note dated as of ____________ 199__, given by Debtor to Lender in the principal amount of $____________ (the "Note");

b. That certain Amended and Restated First Mortgage and Security Agreement (the "Mortgage") executed by Debtor, dated as of the date of the Note and recorded in the Office of the Recorder of Deeds of __________ County, __________ and covering certain property in __________ County, __________, more particularly described in the Mortgage (the "Mortgaged Premises");

c. That certain Security Agreement (Improvements Escrow, Consultant's Escrow, Cash Flow Escrow and Tax Escrow) executed by Debtor and dated of even date herewith;

d. All of the other Restated Loan and Mortgage Documents (as such term is defined in the Mortgage); and

e. The indemnity set forth in Section ___ of that certain Agreement dated as of ______, 199__ among Beneficiary, the Guarantors, _______________, _______________ Management Co., Inc., and _______________ (the "Settlement Agreement");

and any and all modifications, extensions or renewals of or substitutions for, any thereof or collateral given in connection with any thereof, heretofore or hereafter; and the term "Obligations" shall include all such obligations and indebtedness unconditionally, and notwithstanding any right or power of Debtor or anyone else to assert any claim or defense as to the invalidity or unenforceability of any of such obligations or indebtedness, and no such claim or defense shall affect or impair the obligations of Guarantors hereunder. Upon the occurrence of any Event of Default under any of the Restated Loan and Mortgage Documents, or upon any default or breach under the Settlement Agreement, Guarantors will, on demand by Lender or the holder of the Note, pay and perform all of the Obligations. Guarantors further agree to pay on demand all expenses, legal or otherwise (including court costs and attorneys' fees), paid or incurred by Lender in endeavoring to collect the Obligations, or any part thereof, and in enforcing this Guaranty.

2. Limitation on Guaranty. Notwithstanding anything to the contrary contained herein, Lenders' right of recovery and judgment against Guarantors is limited to: (a) $_________________ , plus all costs and expenses (including, without limitation, reasonable attorneys' fees) paid or incurred by Lender in endeavoring to collect on this Guaranty, or any part thereof, and in enforcing this Guaranty and Guarantors' obligations hereunder, plus (b) interest at the Default Rate provided in the Note, on such amounts as are described in clause (a) above at any time due and owing.

3. Covenant Not to Sue. Notwithstanding anything herein to the contrary, Lender covenants and agrees with Guarantors that Lender will not sue Guarantors, or assert any claims against Guarantors in respect of their obligations under this Guaranty, unless and until either (A) both a Conveyance Event (as defined in the Settlement Agreement) and a Challenge (defined hereinafter) have occurred or (B) a Claim (defined hereinafter) is raised which involves or includes the assertion that the transfer of the Mortgaged Premises (or any portion thereof) pursuant to the Escrow Agreement (as defined in the Settlement Agreement) and the Conveyance Documents (as defined in the Settlement Agreement) is or would be unenforceable under applicable law. For purposes of this Section, a "Challenge" shall mean (A) (i) the filing, institution or commencement of a voluntary bankruptcy proceeding by Beneficiary, or (ii) the filing, institution or commencement of an involuntary bankruptcy proceeding or any other action or proceeding against Beneficiary which involuntary proceeding or other such action or proceeding is not dismissed with prejudice within thirty (30) days of its commencement or (B) the filing, institution, commencement or assertion of any suit, cause of action, arbitration proceeding, claim, counterclaim, defense, or action of any kind other than a Permitted Challenge (defined hereafter) (each a "Claim") by any one or more of Beneficiary, Trustee, any Guarantor or any relative or affiliate of or entity controlling, controlled by or under common control with any of the foregoing (an "Affiliated Challenging Partv") or by any other person or entity other than an Affiliated Challenging Party (an "Unaffiliated Challenging Party") of, concerning, related to or in

any way connected with or arising from the Loan and Mortgage Documents (as defined in the Settlement Agreement) or the Restated Loan and Mortgage Documents or the Settlement Agreement, including (without limitation) a Claim (i) which is based, in whole or in part, on the claim, assertion, allegation or premise that a Conveyance Event (as defined in the Settlement Agreement) has not occurred or that Lender (or its designee) is not or was not entitled to obtain title to or ownership of the Mortgaged Premises (regardless of whether by conveyance as provided in the Escrow Agreement, by foreclosure or otherwise), (ii) which in any way challenges or contests, or seeks to impede, delay, bar, stay, enjoin, interfere with, rescind or invalidate, Lender (or its designees) obtaining title to or ownership of the Mortgaged Premises (regardless of whether by conveyance as provided in the Escrow Agreement, by foreclosure or otherwise), or (iii) which is based, in whole or in part, on the claim, assertion, allegation or premise that Lender has acted improperly or in bad faith or in breach of any of its obligations under any of the Restated Loan and Mortgage Documents, under the Settlement Agreement or otherwise. For purposes of this Section, a "Permitted Challenge" shall mean any Challenge (a) consisting of a lawsuit commenced by an Affiliated Challenging Party, in a court which has competent jurisdiction over the parties and the subject matter or of a claim. defense or counterclaim asserted in anv action brought by Lender, its successors or assigns, (b) where one of the claims or the only claim raised or asserted by the Challenging Party is that no Conveyance Event has occurred, (c) in which the court enters a final and nonappealable order or judgment finding that no Conveyance Event has in fact occurred, and (d) involves an assertion that the remedies set forth in Sections ___, ___ and ___ of the Settlement Agreement pertaining to the transfer of the Mortgaged Premises (or any portion thereof) pursuant to the Conveyance Documents are not enforceable remedies as a matter of law.

4. Reliance. It is expressly understood and acknowledged that Lender has entered into the Settlement Agreement in reliance upon the agreement contained therein of Guarantors to enter into this Guaranty, and that Lender has made financial accommodations in reliance upon the execution and delivery of this Guaranty and the validity thereof, and Guarantors have consented to this Guaranty as an inducement to Lender to enter into the Settlement Agreement.

5. Representations and Warranties. Each Guarantor represents and warrants to Lender as follows:

a. Any and all balance sheets, net worth statements and other financial statements or data concerning Guarantors which have heretofore been given to Lender by or on behalf of such Guarantor fairly and accurately present, to the best knowledge, information and belief of the Guarantors, the financial condition of Guarantors as of the respective dates thereof, and, since the respective dates thereof, there has been no material adverse change in the financial condition of Guarantors.

b. The execution, delivery and performance of this Guaranty by Guarantors and the performance of all covenants, agreements and obligations hereunder do not and will not contravene or conflict with (i) the limited partnership agreement of Beneficiary, (ii) any law, order, rule, regulation, writ, injunction, or decree now in effect of any government, governmental instrumentality or court having jurisdiction over Guarantors, or (iii) any contractual restriction binding on or affecting Guarantors or their respective property or assets.

c. This Guaranty constitutes the legal, valid and binding obligation of Guarantors and is enforceable against Guarantors in accordance with its terms.

d. Except as previously disclosed in writing or under oath by Guarantors to Lender, there is no action, proceeding or investigation pending or, to the knowledge of such Guarantor, threatened or affecting Guarantors which may adversely affect Guarantors' ability to fulfill Guarantors' obligations under this Guaranty.

e. Guarantors have disclosed all events, conditions and facts known to Guarantors which could have any material adverse effect on the financial condition of Guarantors. No representation or warranty of Guarantors contained herein, nor any schedule, certificate or other document furnished by Guarantors to Lender in connection with this Guaranty or the Restated Loan and Mortgage Documents or the Settlement Agreement, contains any material misstatement of fact or omits to state a material fact or any fact necessary to make the statements contained therein not misleading.

f. Except as previously disclosed to Lender in writing or under oath, there are no facts or circumstances of any kind or nature whatsoever of which such Guarantor is aware which such Guarantor believes would in any way impair or prevent Guarantors from performing their obligations under this Guaranty in any material respect.

6. <u>Covenants.</u> Each Guarantor agrees and covenants as follows:

a. Guarantors agree that this Guaranty shall continue to be effective or be reinstated, as the case may be, if at any time payment or performance of any of the Obligations, or any part thereof, is avoided, rescinded or waived, or must otherwise be restored, disgorged, reimbursed or repaid by Lender upon the bankruptcy, insolvency or reorganization of Debtor or otherwise and shall continue in full force and effect as long as there exists a possibility that any payment or performance of any of the Obligations may be avoided, rescinded, waived, restored, disgorged, reimbursed or repaid. without limiting the generality of the foregoing, Guarantors agree that to the extent Debtor makes a payment or payments to Lender, which payment or payments or any part thereof are at any time subsequently invalidated, declared to be fraudulent or preferential, set aside or required, for any of the

foregoing reasons or for any other reason, to be repaid or paid over to a custodian, trustee, receiver, or any other party under any bankruptcy code or act, state or federal law, common law or equitable cause, then to the extent of such payment or repayment, the Obligations or any part thereof intended to be satisfied shall be revived and continued in full force and effect as if said payment or repayment had not been made and Guarantors shall be primarily liable for such Obligations.

b. Lender may, from time to time, in its sole discretion and without notice to or consent by Guarantors, take any or all of the following actions, all without in any way diminishing, impairing, releasing or affecting the liability or obligations of Guarantors under or with respect to this Guaranty (and each Guarantor hereby irrevocably consents to Lender doing any or all of the following): (i) retain or obtain a security interest in any property to secure any of the Obligations or any obligation hereunder (provided that nothing in this clause (i) shall otherwise obligate Guarantors to grant any security interest to Lender in any property of Guarantors), (ii) retain or obtain the primary or secondary obligation of any obligor or obligors, in addition to Guarantors, with respect to any of the Obligations, (iii) extend or renew for one or mqre periods (whether or not longer than the original period), or alter or exchange, any of the Obligations, or release or compromise any obligation of Guarantors hereunder or any obligation of any nature of any other obligor with respect to any of the Obligations, or otherwise amend or modify any or all of the Restated Loan and Mortgage Documents or the Settlement Agreement, (iv) waive, modify, subordinate, compromise or release its security interest in, or surrender, release or permit any substitution or exchange for, all or any part of any property securing any of the Obligations or any obligation hereunder, or extend or renew for one or more periods (whether or not longer than the original period) or waive, release, subordinate, compromise, modify, alter or exchange any obligations of any nature of any obligor with respect to any such property, (v) subject to Section 2 and Section 3 hereof, resort to Guarantors for payment of any of the Obligations, whether or not Lender shall have resorted to or exhausted any other remedy or any other security or collateral or any obligation hereunder or shall have proceeded against Beneficiary or any other obligor primarily or secondarily obligated with respect to any of the Obligations, and (vi) grant participations to one or more banks or other financial institutions in and to all or any part of the Note, the Mortgage and the other Restated Loan and Mortgage Documents and the indebtedness evidenced thereby, this Guaranty, or other security documents now or hereafter in existence with respect to the Obligations.

c. No act of commission or omission of any kind or at any time, upon the part of Lender in respect to any matter whatsoever, shall in any way affect or impair this Guaranty.

d. So long as any of the Restated Loan and Mortgage Documents or the Settlement Agreement shall be in effect or any of the obligations shall be owed by Debtor, each Guarantor covenants that:

(1) Such Guarantor will deliver to Lender from time to time, but in no event less than one time per year, on or before April 14 of each year (or within 10 days after any permitted extension of the filing date for such taxes), a financial statement certified as accurate by such Guarantor and copies of such Guarantor's federal and state tax returns and such other information regarding the financial position or business of Guarantors as Lender may reasonably request;

(2) Guarantors will promptly give notice in writing to Lender of all litigation, arbitration proceedings and regulatory proceedings affecting Guarantors or any of them or any of their properties, which reasonably could be expected materially and adversely to affect the financial condition or business of Guarantors in their respective individual capacities or any of them or the ability of Guarantors or any of them to perform the obligations under this Guaranty or which in any manner draws into question the validity of the Restated Loan and Mortgage Documents, the Settlement Agreement or the Obligations; and

(3) Guarantors agree to provide from time to time such other information concerning Guarantors as Lender may reasonably request.

e. Any amounts received by Lender from whatever source on account of the Obligations may be applied by it toward the payment of such of the Obligations or reduction of such portion of the Obligations as, and in such order, proportion and priority of application, as Lender may from time to time elect in its sole and absolute discretion. Guarantors agree that no portion of any sums applied, from time to time, in reduction of the Obligations (other than sums paid by Guarantors pursuant to the provisions of this Guaranty) shall be deemed to have been applied in reduction of Guarantors' obligations under this Guaranty (as limited by Section 2 and Section 3) until such time as the portion of the Obligations other than the guaranteed portion thereof have been paid in full, it being the intention hereof that Guarantors' obligations under this Guaranty (as limited by Section 2 and Section 3) shall be the last portion of the Obligations to be paid and that this Guaranty shall remain in full force and effect and shall not be deemed discharged until the earlier to occur of (1) the date upon which the Obligations have been paid in full, or (2) the date upon which all of the obligations and liabilities of Guarantors hereunder have been performed and discharged by Guarantors in accordance with the provisions of this Guaranty.

f. Guarantors expressly and irrevocably waive any and all rights of subrogation, reimbursement, indemnity, exoneration, contribution and any other claim which either of them may now or hereafter have against Debtor or any other person directly or contingently liable for the Obligations guaranteed hereunder, or against or with respect to any of Debtor’s property (including, without limitation, property collateralizing their obligations to Lender), arising from the existence or performance of this Guaranty.

g. The liability of Guarantors hereunder, and the remedies for the enforcement of such liability, shall in no way be diminished or affected by (i) the release or discharge of Debtor in any creditors', receivership, bankruptcy, reorganization, insolvency or other proceeding, (ii) the rejection or disaffirmance of any document or instrument evidencing, securing, or executed in connection with the Obligations in any such proceeding, (iii) the impairment, limitation or modification of the Obligations or of the estate of Debtor in bankruptcy, or of any remedy for the enforcement of Debtor's liability under any document or instrument evidencing, securing, or executed in connection with the Obligations, resulting from the operation of any present or future provision of title 11 of the United States Code or any other statute or law of any kind or from the decision or order of any court, (iv) any disability or defense of Debtor, or (v) the cessation of the liability of Debtor for any cause whatsoever.

h. The creation or existence from time to time of Obligations in excess of the amount to which the right of recovery under this Guaranty is limited is hereby authorized and permitted, without notice to Guarantors, and shall in no way affect or impair the rights of Lender and the obligations of Guarantors under this Guaranty.

i. Lender shall have no obligation of any kind whatsoever to obtain, perfect or retain a valid lien upon or security interest in any collateral of any kind whatsoever to secure any of the Obligations, or to protect or insure any property which may at any time be the subject of any such lien or security interest, and any failure of Lender to obtain, perfect or retain any such lien or security interest, or to protect or insure any such property, shall in no way impair, diminish, release or affect the obligations of Guarantors hereunder.

j. It is further expressly understood by and between Lender and Guarantors that Guarantors' personal guaranty referred to herein shall not in any way modify or relieve Guarantors of or from any other liability or obligations that Guarantors or any of them may have to Lender relative to any and all documents executed by Guarantors or any of them, including the Restated Loan and Mortgage Documents and the Settlement Agreement, and that any and all said liability shall survive the execution of this Guaranty, and shall remain in full force and effect subsequent to this Guaranty.

k. In order to hold Guarantors liable hereunder (subject to Section 2 and Section 3 hereof), there shall be no obligation on the part of Lender, at any time, to resort for payment to Debtor or other persons or corporations, their properties or estates, or resort to any collateral, security, property, liens or other rights or remedies whatsoever, it being understood that this is a guaranty of payment and performance and not of collection.

l. In the event this Guaranty is executed by more than one person or entity, it is agreed that each shall be bound by all of the provisions hereof, jointly and severally, and, subject to the limitations set forth in Section 2 and Section 3, each shall be obligated for the full payment of the Obligations to Lender, regardless of the existence of any such other guaranty. If more than one Debtor is named herein, this Guaranty shall extend fully to the indebtedness of each such Debtor to Lender.

m. If acceleration of the time for payment of any amount that is guarantied hereunder is stayed or demand for payment of any such amount is precluded upon the insolvency, bankruptcy or reorganization of Debtor (determined without regard to whether a court might act favorably on a request for relief from any such stay or other preclusion), all such amounts otherwise subject to acceleration under the terms of the Restated Loan and Mortgage Documents shall nonetheless be payable by Guarantors hereunder forthwith on demand by Lender.

n. Such Guarantor shall, within five (5) business days after receipt thereof, deliver to Lender copies of any notices of default served on such Guarantor in his individual capacity pursuant to the terms of any other agreement to which either Guarantor is a party where such agreement involves goods, services or obligations with respect to which the fair market value or stated price or value exceeds $10,000.00.

7. Waivers. Each Guarantor hereby expressly waives:

a. notice of the acceptance by Lender of this Guaranty,

b. notice of the existence or creation or non-payment of all of any of the Obligations,

c. presentment, demand, notice of dishonor, protest, notice of protest, default, nonpayment, and all other notices whatsoever,

d. all diligence in collection or protection of or realization upon the Obligations or any thereof, any obligation hereunder, or any security for or guaranty of any of the foregoing,

e. any right of subrogation against Debtor, except as provided in Section 23,

f. its right to enforce any remedies Lender now has, or later may have, against Debtor, except as provided in Section 23,

g. any right to participate in any security now or hereafter held by Lender, except as provided in Section 23, and

h. all suretyship defenses and suretyship rights of every nature otherwise available.

8. Effect of Delay or Action. No delay on the part of Lender in the exercise of any right or remedy shall operate as a waiver thereof, and no single or partial exercise by Lender of any right or remedy shall preclude other or further exercise thereof or the exercise of any other right or remedy, nor shall any modification or waiver of any of the provisions of this Guaranty be binding upon Lender except as expressly set forth in a writing duly signed and delivered on behalf of Lender. No action of Lender permitted hereunder shall in any way affect or impair the rights of Lender or the obligations of Guarantors under this Guaranty.

9. Successors and Assigns: Participations. All of the representations, warranties, undertakings, agreements and covenants herein contained and the obligations hereunder shall be binding upon Guarantors and their respective heirs, executors and legal and personal representatives, and upon their respective successors and assigns; and to the extent that Debtor or any Guarantor is either a partnership or a corporation, all references herein to Debtor and to such Guarantor, respectively, shall be deemed to include any and all successors, whether immediate or remote, to such partnership or corporation. Lender may, without any notice whatsoever to anyone, sell, assign or transfer all of the Restated Loan and Mortgage Documents or the obligations, or any part thereof, and in that event each and every immediate and successive assignee, transferee, or holder of all or any part of the Restated Loan and Mortgage Documents or the obligations shall have the right to enforce this Guaranty, by suit or otherwise, for the benefit of such assignee, transferee or holder, as fully as if such assignee, transferee or holder were herein by name specifically given such rights, powers and benefits; but Lender shall have an unimpaired right, prior and superior to that of any said assignee, transferee or holder, to enforce this Guaranty for the benefit of Lender, as to so much of the Restated Loan and Mortgage Documents or the Obligations as it has not sold, assigned or transferred.

10. Continuing and Unconditional Guaranty. This Guaranty shall in all respects be a continuing, absolute, irrevocable and unconditional guaranty, and shall remain in full force and effect (notwithstanding, without limitation, the death, withdrawal, bankruptcy, dissolution or termination of the existence of Debtor or of any Guarantor) until all of the following have occurred: (i) Guarantors have no further monetary obligation of any kind under or with respect to this Guaranty, (ii) all of Guarantors' obligations hereunder (including, without limitation, costs of collection hereunder) have been paid and satisfied in full, (iii) Lender has no further obligation to make any advance or extend any credit under any agreement to which this Guaranty would apply, and (iv) all indebtedness and other amounts owed by Beneficiary or Trustee under the Restated Loan and Mortgage Documents or the Settlement Agreement have been paid in full. No notice of discontinuance given by the Guarantors shall affect or impair any of the agreements or obligations

of Guarantors hereunder, and all of the agreements and obligations of Guarantors under this Guaranty shall, notwithstanding any notice of discontinuance, remain fully in effect until the conditions set out in the preceding sentence have been satisfied.

11. No Exculpation. No exculpatory, “non-recourse” or other language or provision contained in the Settlement Agreement, the Note or in any other document or instrument shall in any way prevent or limit Lender from proceeding to enforce this Guaranty against Guarantors personally. It is further expressly understood by and between Lender and Guarantors that Guarantors' personal guaranty referred to herein shall not in any way modify or relieve Guarantors of or from any other liability or Qbligations that Guarantors or any of them may have to Lender relative to any and all documents executed by Guarantors or any of them, including the Restated Loan and Mortgage Documents or the Settlement Agreement, and that any and all said liability shall survive the execution of this Guaranty, and shall remain in full force and effect subsequent to this Guaranty.

12. Mortgage on Real Property. Each Guarantor authorizes Lender, at its sole option, without notice or demand and without affecting the liability of Guarantors hereunder, to release and reconvey (with or without the receipt of any consideration) any lien against any or all of the security, and to foreclose the Mortgage by judicial sale, or to accept a conveyance of the Mortgaged Premises, all without affecting the liability of Guarantors hereunder. Each Guarantor expressly waives any defense to the recovery by Lender from such Guarantor of any deficiency, including without limitation any defense arising as a result of any election of remedies by Lender which limits or destroys Guarantors' right to proceed against Debtor. Each Guarantor waives all suretyship defenses it would otherwise have. Each Guarantor waives any right to receive notice of any judicial sale or foreclosure or conveyance of any real property, and the failure of Guarantors to receive such notice shall not impair or affect Guarantors' liability hereunder.

13. Guarantv of Payment. In order to hold Guarantors liable hereunder (subject to Section 2 and Section 3 hereof), there shall be no obligation on the part of Lender, at any time, to resort for payment to Debtor, or other persons or corporations, their properties or estates, or resort to any collateral, security, property, liens or other rights or remedies whatsoever. The obligations of Guarantors hereunder are independent of the obligations of Debtor, notwithstanding any right or power of the Debtor or any other person or entity to assert any claim or defense as to the invalidity or unenforceability of the Obligations or of any provision of the Settlement Agreement, the Restated Loan and Mortgage Documents or the Conveyance Documents, and no such claim or defense shall impair the obligations of the undersigned hereunder. A separate action may be brought and prosecuted against Guarantors, and any requirement that Lender institute suit, or exercise or exhaust its remedies or rights against Debtor or against any other person, guarantor, or mortgage, or other collateral guaranty securing all or any part of the Obligations, prior to enforcing any rights it has under this Guaranty, or otherwise, is hereby expressly waived, and

Guarantors hereby further waive the benefit of any statute of limitations affecting their liability hereunder or the enforcement hereof. Guarantors agree that their liability hereunder is primary, absolute and unconditional without regard to the liability of any other party, it being understood that (subject to Section 2 and Section 3 hereof) this Guaranty is a guaranty of payment and performance and not of collection.

14. Time of Essence. Time is of the essence of this Guaranty.

15. No Modification Without Writing. This Guaranty may not be modified, amended, revised, revoked, terminated, changed or varied in any way whatsoever except by the express terms of a writing signed by the party or parties sought to be bound thereby.

16. Rights Cumulative. The rights and remedies of Lender hereunder are cumulative and in addition to any and all other rights and remedies specified herein or in the Restated Loan and Mortgage Documents or in the Settlement Agreement or available at law or in equity.

17. Knowledge and Information. Guarantors, and each of them, are fully aware of the financial condition of Debtor (and the partners thereof) and of the Mortgaged Premises, and are executing and delivering this Guaranty based solely upon their own independent investigation of all matters pertinent hereto and are not relying in any manner upon any representation or statement of Lender with respect thereto. Guarantors are in a position to obtain, and hereby assume full responsibility for obtaining, any additional information concerning the financial condition of Debtor (and the partners thereof) and of the Mortgaged Premises as Guarantors may deem material to their obligations hereunder, and Guarantors are not relying upon, nor expecting, Lender to furnish them any information concerning the financial condition of Debtor (or the partners thereof) or the Mortgaged Premises. Guarantors shall have no right to require Lender to obtain or disclose any information with respect to the Obligations, the financial condition or character of Debtor (or the partners thereof) or the Mortgaged Premises, or Debtor's (or the partners' thereof) ability to pay the obligations or any other person, or any other matter, fact or occurrence whatsoever.

18. GOVERNING LAW. THIS GUARANTY SHALL BE CONSTRUED ACCORDING TO THE LAWS OF THE STATE OF _______________, IN WHICH STATE IT SHALL BE PERFORMED BY GUARANTORS. GUARANTORS AND LENDER HEREBY AGREE THAT ALL ACTIONS TO ENFORCE THE TERMS AND PROVISIONS OF THIS GUARANTY SHALL BE BROUGHT AND MAINTAINED ONLY WITHIN THE STATE OF _______________ AND GUARANTORS AND LENDER HEREBY CONSENT TO THE EXCLUSIVE JURISDICTION OF ANY COURT WITHIN THE STATE OF _______________, WAIVE PERSONAL SERVICE OF ALL PROCESS AND HEREBY CONSENT THAT SUCH SERVICE MAY BE MADE BY REGISTERED OR CERTIFIED MAIL, DIRECTED TO GUARANTORS OR TRAVELERS (AS THE CASE MAY BE), AT THE RESPECTIVE ADDRESSES HEREINAFTER SET FORTH. GUARANTORS, JOINTLY AND SEVERALLY, HEREBY EXPRESSLY WAIVE, AND LENDER HEREBY EXPRESSLY WAIVES, ANY AND ALL RIGHTS WHICH THEY OR IT MAY HAVE TO MAKE ANY OBJECTIONS

BASED ON (A) JURISDICTION, TO ANY SUIT BROUGHT TO ENFORCE THIS GUARANTY IN THE STATE OF _______________, OR (B) VENUE, TO ANY SUIT BROUGHT TO ENFORCE THIS GUARANTY IN _______________ COUNTY, _______________, IN EACH CASE IN ACCORDANCE WITH THE ABOVE PROVISIONS.

19. Notices. Any notice, demand or other communication to be given hereunder shall be effectively given if made in writing, and delivered either personally or by United States certified or registered mail, postage prepaid, return receipt requested (which shall be deemed received upon the earlier of receipt or three (3) days after the deposit thereof with the United States Postal Service) to Lender or Guarantors (and their respective counsel) at their respective addresses set forth below or to such other addresses as Lender or Guarantors may direct in a notice complying with this Section:

Lender: _____________________
____
____

Attn: ________________

With a copy to: __________________
____
____

Guarantors: ___________________
____
____

and

____
____

With a copy to: __________________
____
____

20. Severability. If any provision of this Guaranty or the application thereof to any person or circumstance shall, to any extent, be invalid or unenforceable, the remainder of this Guaranty shall be valid and enforceable to the fullest extent permitted by law.

21. WAIVER OF JURY TRIAL. EACH GUARANTOR WAIVES ANY RIGHT TO A TRIAL BY JURY IN ANY ACTION OR PROCEEDING IN CONNECTION WITH THIS GUARANTY OR THE OTHER RESTATED LOAN AND MORTGAGE DOCUMENTS OR THE SETTLEMENT AGREEMENT OR ANY DOCUMENT REFERENCED THEREIN OR EXECUTED AND DELIVERED IN CONNECTION THEREWITH.

22. Capitalized Terms. Any term capitalized but not specifically defined herein, which is capitalized and defined in the Note, shall have the same meaning for purposes of this Guaranty as it has for purposes of the Note.

23. Subrogation. Notwithstanding anything to the contrary in this Guaranty, the waivers contained in sections 7(e), (f) and (g) shall apply only until all of the Obligations and the Guaranty have been satisfied in full.

SIGNED AND DELIVERED by the undersigned Guarantors, as of the ________________________ day of ___________________, 199__.

By: __________________________,

Name: __________________________,
Individually as Guarantor

By: __________________________,

Name: __________________________,
Individually as Guarantor

Accepted this _____ day of ______,19__

By: __________________________ (“Lender”)

By: ____________________
Name: ____________________
Title: ____________________

STATE OF ___________________)
) SS.
COUNTY OF _________________)

Before me, a Notary Public in and for said County and State, personally appeared ____, and acknowledged the execution of the foregoing "Guaranty" as his voluntary act and deed.

WITNESS my hand and Notarial Seal this ______ day of _____________________ 19

____
Notary Public

____
(Printed Signature)

My Commission Expires: _____________________

My County of Residence: _____________________

STATE OF ____________________)
) SS.
COUNTY OF __________________)

Before me, a Notary Public in and for said County and State, personally appeared ____, and acknowledged the execution of the foregoing "Guaranty" as his voluntary act and deed.

WITNESS my hand and Notarial Seal this _______ day of ______________________ 19

____
Notary Public

____

(Printed Signature)

My Commission Expires: ______________________

My County of Residence: ______________________

EXPLODING AND SPRINGING GUARANTIES

By John C. Murray
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Exploding Guaranties

The form of guaranty attached hereto as **"Exhibit A"** is often referred to as an "exploding guaranty." An individual or entity that is a direct or beneficial owner and/or holder of an equity interest in the borrower usually executes this form of guaranty. The lender in connection with a loan modification or deed-in-escrow transaction or as part of a joint or prepackaged borrower bankruptcy or consensual reorganization may require an exploding guaranty.

In these types of transactions -- which are designed to avoid or delay foreclosure by the lender -- the borrower is entitled to a "second chance" to perform under the loan documents, as same may have been modified by the parties. As part of such workout arrangements the borrower may be required to deposit a deed into escrow, which is to be delivered immediately to the lender if the workout does not succeed and the loan again goes into default.

Under the exploding guaranty, the entire debt (or some agreed-upon portion thereof) is guaranteed and the guaranty is valid, effective and binding as of the date the transaction is closed and the guaranty is executed. The guarantor guarantees payment in full of the loan upon the occurrence of certain future events, such as: the filing of a bankruptcy petition by or against the borrower; the assertion of lender-liability claims against the lender; the institution of litigation by the borrower seeking injunctive relief or otherwise seeking to prevent the lender from exercising its remedies under the workout document or underlying loan documents; the contesting of a subsequent foreclosure or enforcement proceeding filed by the lender; or the violation of certain covenants in the loan documents. The guaranty terminates upon the occurrence of certain specified events, such as payment in full of the loan, the successful completion of a foreclosure sale, or delivery of the property to the lender via a deed in lieu of foreclosure or pursuant to an escrow agreement.

Springing Guaranties

Under a similar concept known as a "springing guaranty," the guarantor executes a guaranty at the closing of the loan workout. However, the guarantor's obligations under the guaranty become effective only upon the happening of certain specified events in the future, similar to those that would cause the lender to enforce the guarantor's obligations under an exploding guaranty. Sometimes the springing guaranty is structured to provide that, even after it becomes effective, it still may terminate upon the occurrence of certain subsequent events, such as payment in full of the outstanding loan balance. A form of springing guaranty is attached hereto as **Exhibit "B."**

Variations of Exploding and Springing Guaranties

Other variations of these types of guaranties include the following: a "shrinking" guaranty (where the guarantor's liability diminishes as certain specified events occur); a "creeping" guaranty (where the guarantor's liability increases if certain specified events occur); and an indemnity and hold-harmless agreement which is executed by a third party who agrees to absolutely and unconditionally indemnify the lender (subject to a maximum dollar limit or "liquidated damages" amount) for all losses the lender may incur as the result of certain actions by the borrower that prevent, hinder, or delay the lender in connection with the attempted exercise of any of its remedies against the borrower as set forth in the relevant workout (or related) document. (A form of such an indemnity agreement is attached hereto as **Exhibit "C"**).

Enforceability in Bankruptcy Proceedings

The validity and enforceability of springing and exploding guaranties may be attacked in a bankruptcy proceeding on a number of theories (which may or may not be successful). The borrower, guarantor (or other creditors) may claim that the "springing" and "exploding" features of these types of guaranties are unenforceable *ipso facto* clauses under Sections 363(l), 365(e), and 541(c) of the Bankruptcy Code. *See, e.g.*, *DiCello v. United States (In re Railway Reorganization Estate, Inc.)*, 133 B.R. 578, 582 (Bankr. D. Del. 1991) (Government's "springing liens" on certain assets of debtor railroad were unenforceable *ipso facto* clauses).

All or some of these parties could also argue that such clauses are inequitable and therefore unenforceable under § 105 of the Bankruptcy Code (which grants the court the power to "issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title"). It could even be argued that the lender's right to proceed against the guarantor under the guaranty for a monetary judgment constitutes an unreasonable and impermissible penalty under § 506(b) of the Bankruptcy Code (which provides that an oversecured creditor may recover postpetition interest in addition to "reasonable fees, costs, and charges" as part of its secured claim).

A claim could also conceivably be made that the enforcement of such guaranties violates the automatic-stay provisions of § 362 of the Bankruptcy Code, and that a bankruptcy court should enjoin the enforcement of such a guaranty upon the filing of a bankruptcy petition by or against the borrower. *See, e.g., North Star Contracting Corp. v. McSpedan*, 125 B.R. 368, 370-71 (S.D.N.Y. 1991) (finding that action against corporate debtor's president violated automatic stay because situation presented "special circumstances" based on identity of interests of debtor and third-party non-debtor)*; cf. Sentry Bank and Trust Co. v. Goulding Place Developers, Inc. (In re Goulding Place Developers, Inc.)*, 99 B.R.493, 497-98 (Bankr.N.D.Ga. 1989) (corporate debtor's Chapter 11 filing did not constitute bad faith so as to entitle creditor to relief from automatic stay to recover under guaranty executed by an officer of the debtor, where underlying note was only in technical default upon individual borrower's Chapter 11 filing and bankruptcy filing was necessary to preserve debtor's equity in the property); *In re Metal Center, Inc.*, 31 B.R. 458, 463 (Bankr.D.Conn. 1993) (finding that collateral estoppel would not apply in a bankruptcy automatic stay issue, because a judgment in the suit against the third party would not be binding on the bankruptcy court); *Brancato v. Trust Co. of Georgia Bank of Savannah, N.A. (In re Pestritto)*, 108 B.R. 850, 852 (Bankr.S.D.Ga. 1989) (foreclosure action against property in which debtor had transferred all of its legal and/or equitable interests was not subject to automatic stay, absent showing that foreclosure would have effect upon debtor's property or estate); *National Westminster Bank NJ v. Lomker*, 277 N.J.Super. 491, 494, 649 A.2d 1328, 1330 (1994) (finding that automatic stay did not extend to creditor's suit against debtor's individual guarantors); *Willis v. Ceoltex Corp.*, 978 F.2d 146, 148-49 (4th Cir. 1991) (holding that automatic stay did not apply to an irrevocable letter of credit issued by bank to debtor's surety and that surety could draw on letter of credit because it was not property of bankruptcy estate, without violating automatic stay).

Section 524(e) of the Bankruptcy Code provides that a bankruptcy discharge does not discharge the obligation of any non-debtor party. Courts have generally construed this statutory provision as prohibiting bankruptcy plans from modifying or releasing the obligations and liabilities of guarantors under third-party guaranties and prohibiting bankruptcy courts from preventing the enforcement of such guarantees. *See, e.g., Star Phoenix Mining Co. v. West One Bank*, 147 F.3d 1145, 1147 (9th Cir. 1998) ("under § 524(e), a bankruptcy court does not have the power to discharge the liabilities of a bankrupt's guarantor"); *In re Western Real Estate Fund, Inc.,* 922 F.2d 592, 601 (10th Cir. 1991) (finding that "[n]either the confirmation of a plan nor the creditor's recovery (or partial satisfaction) thereunder bars litigation against third parties for the remainder of the discharged debt"); *In re Sandy Ridge Devel. Corp.*, 881 F2d 1346, 1351 (5th Cir. 1989) (confirmation of plan would not release non-debtor guarantors); *Mellon Bank v. M.K. Siegel*, 96 B.R. 505, 506 (Bankr. E.D. Pa. 1989) (holding that the bankruptcy court lacked the power to discharge the obligations of non-debtor guarantors of the debtors' obligations to creditors); *Union Carbide Corp. v. Newboles*, 686 F.2d 593, 594-95 (7th Cir. 1982) (holding that the bankruptcy court's discharge of the liability of a guarantor did not preclude a collateral action by the creditor to enforce the guaranty); *Peterson v. Peterson*, 118 B.R. 801, 803 (Bankr. D. New Mexico 1990) (affirming that the discharge of the debt did not affect the liability of any other entity for such debt); *Underhill v. Royal*, 769 F.2d 1426, 1431-32 (9th Cir. 1985) (holding that a bankruptcy court's discharge of the liability of co-debtors or guarantors is without effect and does

not bar collateral actions against such co-debtors or guarantors by creditors of the debtor); *R.I.D.C. Indus. Devel. Fund v. Snyder*, 539 F.2d 487, 490 (5th Cir. 1976), *cert. denied*, 429 U.S. 1095 (1977) (holding that a bankruptcy court has no power to affect the obligations of guarantors); *In re Prime Motor Inns, Inc.*, 130 B.R. 610, 613 (S.D. Fla. 1991), (permitting lender to proceed against third-party issuer of a letter of credit when borrower's bankruptcy triggered lender's right to cash letter of credit); *In re Spanish Cay, Ltd.*, 161 B.R. 715, 722 (Bankr. S.D. Fla. 1993) (upholding enforceability of agreement that required insiders to assign their claims against debtor to creditor, which assignment would be effective upon commencement of any bankruptcy or insolvency proceeding with respect to debtor); *In re Murall, Inc*., 118 B.R. 400, 403 (Bankr. D.S.C. 1989) (denying injunction against enforcement of guaranty because of lack of evidence of irreparable injury or substantial harm to others, or any overriding public interest or threat to the likelihood of a successful reorganization); *In re Rubenstein*, 105 B.R. 198, 204 (Bankr.D.Conn. 1989) (refusing to enjoin action against debtor's mortgagee because debtor would not be bound by a judgment in that matter); *Apollo Molded Products, Inc. v. Kleinman (In re Apollo Molded Products, Inc.)*, 83 B.R. 189, 194 (Bankr.D.Mass. 1988) ("[w]e . . . align ourselves with those courts who have refused to enjoin suit against the debtor's guarantor, even for a very short period of time, absent extraordinary circumstances"); *Kalispell Feed & Grain Supply, Inc. v. Norwest Bank Kalispell, N.A. (In re Kalispell Feed & Grain Supply, Inc.)*, 55 B.R. 627, 629 (Bankr. D. Mont. 1985) (denying injunction against guarantors because debtor would not be bound by any judgment against guarantors and judgment would not prejudice sale of debtor's assets); *St. Petersburg Hotel Assocs., Ltd. v. Royal Trust Bank of St. Petersburg (In re St. Petersburg Hotel Assocs.)*, 51 B.R. 18, 19 (Bankr. M.D. Fla. 1984) (dissolving injunction where debtor was able to obtain financing that did not require credit strength of guarantor, as previously alleged); *Mahaffey v. E-C-P of Ariz., Inc.*, 40 B.R 469, 473-74 (Bankr. D. Colo. 1984) (injunction denied where evidence established that guarantor did not intend to contribute any of his assets to debtor's reorganization and creditor was otherwise unprotected by any other available assets if it were ordered not to proceed against guarantor); *First Nationwide Bank v. Brookhaven Realty Associates*, 637 N.Y.S.2d 418, 421, 223 A.D.2d 618, 620 (N.Y. App. Div. 1996) (finding that bankruptcy default provision in nonrecourse mortgage, which permitted mortgagee to seek deficiency judgment against mortgagor and its individual partners if bankruptcy proceeding was not dismissed within 90 days, did not violate section of Bankruptcy Code preventing enforcement of *ipso facto* bankruptcy clauses); *Kopolow v. P.M. Holding Corp. (In re Modern Textile, Inc.*), 900 F.2d 1184, 1191 (8th Cir. 1990) ("the liability of a guarantor for a debtor's lease obligations is not altered by the Trustee's rejection of the lease"); *In re Farm Fresh Supermarkets of Maryland, Inc.*, 2001 Bankr. LEXIS 51 at *5 and *7 (rejecting bankruptcy trustee's argument that proceeds of letter of credit posted for benefit of landlord creditor should be returned to bankruptcy estate where creditor drew on the letter of credit post-petiton; and finding that "a standby letter of credit . . . is a distinct type of financing document that is more akin to a guarantee than to the usual letter of credit" and that "it was more of a guarantee than a regular letter of credit which is typically issued in sales of goods"); *American Nat'l Bank and Trust Co. of Chicago v. Hamilton Ind. International, Inc.*, 583 F.Supp. 164, 169 (N.D. Ill. 1984) ("[t]he distinction between a standby letter of credit and a true guarantee is that the former is a direct obligation to pay upon 'specified documents showing a default' while the latter is a secondary obligation requiring 'proof of the fact of default'" (citations omitted)); *Consolidated Aluminum Corp. v. Bank of Virginia*, 544

F.Supp. 386, 394, *aff'd* 704 F.2d 136 (4th Cir. 1983) ("[t]he standby letter of credit functions somewhat in the manner of a guaranty or a surety bond, and thus is utilized to guarantee the performance of a wide variety of obligations"); *American Hardwoods, Inc. v. Deutsche Credit Corp. (In re American Hardwoods, Inc.)*, 885 F.2d 621, 626 (9th Cir. 1989) (rejecting debtor's request to preliminarily and permanently enjoin creditor from pursuing state-court action against guarantor of debtor's plan); *In re Zale Corp.*, 62 F.3d 746, 760 (5th Cir. 1996) (following *American Hardwoods*, *supra*, and stating that it "must overturn a § 105 injunction if it effectively discharges a nondebtor").

However, notwithstanding § 524(e) of the Bankruptcy Code and the aforementioned cases, other bankruptcy courts have granted permanent injunctions preventing secured creditors from proceeding against third-party guarantors, or have modified or waived the obligations contained in such guarantees (generally in cases involving extraordinary fact situations, such as mass-tort litigation bankruptcies or instances where the court has determined that the guarantor is an indispensable party to the successful rehabilitation of the bankrupt debtor). *See, e.g., Menard–Sanford v. Mabey (In re A.H. Robins Co.)*, 880 F.2d 694, 702 (4th Cir. 1989), *cert. denied*, 493 U.S. 959 (1989) (holding that § 524(e) did not limit the equitable power of the bankruptcy court to enjoin suits against other entities where the entire reorganization depended on whether the debtor was free from indirect claims against partners who would have indemnity or contribution claims against the debtor); *MacArthur Co. v. Johns-Manville Corp. (In re Johns-Manville Corp.)*, 837 F.2d 89, 93-94 (2nd Cir. 1988), *cert. denied*, 493 U.S. 959 (1989) (ruling that the bankruptcy court had jurisdiction to enjoin a lien holder from attempting to assert his lien against property in the hands of a purchaser who had acquired a title from the bankruptcy court free and clear of liens and encumbrances; the court cited § 105(a) of the Bankruptcy Code and stated that this section "has been construed liberally to enjoin suits that might impede the reorganization process" and noted that to permit actions against third parties in this case would "adversely affect the property of the estate and would interfere with reorganization"); *In re Boston Harbor Marina Co.*, 157 B.R. 726, 730 (Bankr.D.Mass. 1993) ("[t]he statutory prohibition against discharge of third parties may nevertheless not apply in certain circumstances. The discharge of mass tort claims is one such circumstance"); *In re Burstein-Applebee Co.*, 63 B.R. 1011, 1020-21 (Bankr. W.D. Mo. 1986) (permanently enjoining a debtor's principals from pursuing a state-court action against members of the creditors' committee, a non-debtor); *In re Master Mortgage Investment Fund, Inc.*, 168 B.R. 930, 935-36 (Bankr. W.D. Mo. 1994) (holding that, under appropriate circumstances, a bankruptcy court has the power to issue a permanent injunction or third-party release to protect non-debtors from creditor enforcement actions; the court noted that creditor approval is "the single most important factor" in determining whether a discharge of a non-debtor's obligation is appropriate); *In re Specialty Equipment Companies, Inc.*, 3 F.3d 1043, 1047 (7th Cir. 1993) ("a per se rule disfavoring all releases in a reorganization plan would be . . . unwarranted, if not a misreading of the statute [§ 524(e)]"); *Chase Manhattan Bank v. Third Eighty-Ninth Assoc. (In re Third Eighty-Ninth Assocs.),* 138 B.R. 144, 146-48 (S.D.N.Y. 1992) (enjoining action against guarantor because of indispensability of guarantor to debtor's business and reorganization); *Lazarus Burman Assoc. v. Nat'l Westminster Bank USA (In re Lazarus Burman Assoc.)*, 161 B.R. 891, 899 (Bankr.E.D.N.Y. 1993) (based on finding that facts of the instant case satisfied the same criteria set for in *In re Third Eighty-Ninth, supra,* injunction would issue to prevent lender from

pursuing actions against non-debtor principals); *Codfish Corp. v. Federal Deposit Ins. Corp.) (In re Codfish Corp.)*, 97 B.R. 132, 136 (Bankr. D.P.R. 1988) (granting an injunction under § 105(a) based on determination that operation of debtor's business depended on guarantor, who was one of approximately only 50 persons in the world with the technical expertise to run the business); *F.T.L., Inc. v. Crestar Bank (In re F.T.L., Inc.)*, 152 B.R. 61, 64 (Bankr. E.D. Va. 1993) (granting injunction because of necessity of active involvement of guarantor/principal to ensure confirmable plan and determination that creditor was receiving adequate protection payments and would not be harmed by delay in enforcement of guaranty); *In re Gathering Restaurant, Inc.*, 79 B.R. 992, 1001-02(Bankr. N.D. Ind. 1986 (granting injunction against guarantor because guarantor was only immediate source of emergency loans required to ensure debtor's continued existence as going-concern business); *Kasual Kreation, Inc. v. Heller Fin., Inc. (In re Kasual Kreation, Inc)*, 54 B.R. 915, 917 (Bankr. S.D. Fla. 1985) (granting injunction where guarantors were determined to be indispensable for continued operation of debtor's business during crucial holiday season and creditors would not be substantially harmed); *In re Ionosphere Clubs, Inc.*, 111 B.R. 423, 435 (Bankr.S.D.N.Y. 1990, *aff'd in part*, 124 B.R. 35 (S.D.N.Y. 1991) (enjoining an action against the debtor airline's codefendants, including the chairman of the board of directors, because a finding of liability as to the codefendants could extend to the airline and collateral estoppel could prevent it from litigating factual and legal issues critical to its defense in other proceedings); *In re Lomas Fin. Corp*, 117 B.R. 64, 66-67 (S.D.N.Y. 1990) (staying an action against a corporate debtor's officers because debtor's reorganization efforts would suffer irreparable harm); *Sudbury, Inc. v. H. Escott*, 140 B.R. 461, 463 (Bankr.N.D.Ohio 1992) (enjoining fraud action against officers and directors of corporate debtor because of collateral estoppel concerns); *In re American Film Technologies*,175 B.R. 847, 853-54 (Bankr.D.Del. 1994) (invoking § 105 of Bankruptcy Code to stay prosecution of state law case against debtor's officers and directors, based on "unusual circumstances" of identity of subject matter, issues, and parties involved); *In re Monroe Well Service, Inc.*, 67 B.R. 746, 753-54 (Bankr.E.D.Pa. 1986) (injunction prohibiting creditor from taking action may be appropriate when non-debtor owns assets that will either be a source of funds for debtor or when presentation of non-debtor's credit standing will play significant role in debtor's attempt to organize); *In re Arrowmill Devel. Corp.*, 211 B.R. 497, 502 (Bankr.D.N.J. 1997) (where debtor-corporation's proposed Chapter 11 plan required non-debtor equity interest holder to make capital contributions that would directly affect estate assets and allocations among creditors, court could entertain release of equity interest holder's liability and thereby enter relief between non-debtors); *First Fed. Sav. & Loan Assoc. of Little Rock v. Pettit*, 12 B.R. 147, 149 (Bankr. E.D. Ark. 1981) (enjoining action against co-debtor who was close relative and that involved personal residence, and ruling that such an action, under these facts and circumstances, would unduly interfere with debtor's rerorganization plan); *In re Seatco, Inc.*, 257 B.R. 469, 475 (Bankr. N.D. Tex. 2001) (ruling that a provision of a Chapter 11 plan providing for a temporary injunction against collection on a guaranty, while preserving the rights of the beneficiary of the guaranty and the liability of the guarantor, did not violate § 524(e)); *In re Zale Corp.*, *supra*. 62 F.3d at 762 (noting, in *dicta*, that circumstances may arise in a bankruptcy case warranting the issuance of a temporary injunction of third-party actions in connection with confirmation of the debtor's plan).

See also Howard C. Buschman III and Sean P. Madden, *The Power and Propriety of Bankruptcy Court Intervention in Actions Between Nondebtors*, 47 Bus. Law. 913 (1992); Marshall E. Tracht, *Contractual Bankruptcy Waivers: Reconciling Theory, Practice, and Law,* 82 Cornell L. Rev. 301, 313-14 (1997); Howard J. Weg, *Restricting Access to Bankruptcy Relief: Limiting the Assumption or Rejection of Executory Contracts*, 1999 ICSC U.S Shopping Center Law Conference, Scottsdale Arizona, October 20-23, 1999, Tab 27, pp. 26-27.

Equitable Subordination and Control Issues

The lender must also be careful to exercise some degree of caution and discretion in connection with the events in exploding and springing guarantees that trigger liability of the guarantor (with respect to both the substance and number of such events), so that it does not open itself up to a claim by the debtor or other creditors of overreaching, "control" of the borrower or its business, or lender liability. An especially onerous form of exploding or springing guaranty could conceivably give rise to a claim that the lender is indirectly controlling the borrower's conduct or business operations to the detriment of other creditors.

Section 510(c) of the Bankruptcy Code permits the bankruptcy court to subordinate, on equitable grounds, all or part of a lender's allowed claim or interest, to transfer any lien securing a subordinated claim to the bankruptcy estate, or to disallow the claim entirely, in the appropriate circumstances. Bankruptcy courts generally invoke the sanctions set forth in § 510(c) when the lender has engaged in overreaching or lender control, which occurs when the lender steps beyond the traditional role of a lender and participates in the debtor's business or engages in other egregious conduct that justifies the use of the court's equitable powers. In these situations, the court may decide to subordinate, recharacterize, or even disallow a transaction that would not constitute a preferential transfer (under § 547 of the Bankruptcy Code) or a fraudulent conveyance (under § 548 of the Bankruptcy Code). The principles of equitable subordination are not set out in the Bankruptcy Code, and are defined by case law. In general, the equitable-subordination doctrine is limited to reordering priorities and does not permit total subordination of a claim.

Applications to Conduit and CMBS Financing

Springing and exploding guarantees (which have been around for several years with respect to conventional commercial mortgage-loan financing) are now being utilized in connection with bankruptcy-remote structures in conduit and commercial-mortgage-backed-securities financing. In connection with such financing, the guarantor's obligations under a springing guarantee (or liability under an exploding guaranty) could be triggered by a breach of the bankruptcy-remote entity's loan covenants that are designed to assure the continuance of the single-purpose, bankruptcy-remote features of the entity (e.g., covenants not to incur additional debt except for trade debt, engage in another business activity, or merge with another entity). An additional triggering event could be the breach of the bankruptcy-remote borrowing entity's covenant, in a workout document, not to contest an automatic-relief-from-bankruptcy-stay provision in the event that a bankruptcy petition is subsequently filed by or against the entity. Other triggering events

(applicable in a subsequent bankruptcy proceeding) could include the entity's proposal of a plan of bankruptcy reorganization plan that is not acceptable to or approved by the lender, the entity's opposition to the lender's motion to limit (or terminate) the exclusive time period within which the entity may file a plan of reorganization, and the opposition of the entity to a motion by the lender for the use, or turnover, of rents or other cash collateral.

Most property-specific transactions that are rated by the rating agencies are nonrecourse, without personal liabilities or guaranties. However, occasionally a rated entity will guarantee all or some portion of the debt. For example, a rated company that is an equity participant in a limited-partnership borrower may agree to guarantee some portion of the borrower's obligations in order to facilitate financing for the borrower. In order for the rating agency to rely on the guaranty in connection with its rating of the transaction, it may require that the guarantor and the guaranty agreement comply with the rating agency's "guarantee criteria."

EXHIBIT "A"

GUARANTY AGREEMENT

THIS GUARANTY AGREEMENT ("this Guaranty"), dated as of the ____ day of ____, _____, is made by ________, an individual ("Guarantor"), in favor of ___________, a _____ _____ ("Lender") in connection with that certain **[Amendment to Loan Documents, Security Agreement and Agreement Concerning Mortgage Loan]** of even date herewith (as amended, restated, supplemented or otherwise modified and in effect from time to time, the "Agreement") between _____________, a _______________ ("Borrower") and Lender.

RECITALS

A. Pursuant to the Agreement, Lender has agreed to make certain financial accommodations for the benefit of Borrower.

B. Guarantor **[is a direct or beneficial owner and holder of equity interests in Borrower and]** otherwise derives material financial and other considerations and benefits from Borrower. Accordingly, Guarantor will derive substantial financial and other benefits from the extension of credit to Borrower for which the Agreement provides.

C. Lender is willing to make the financial accommodations set forth in the Agreement upon the condition, among other things, that Guarantor execute and deliver to Lender this Guaranty.

In consideration of the foregoing facts and in order to induce Lender to enter into the Agreement and to make the financial accommodations contemplated thereunder, Guarantor hereby agrees as follows:

1. Definitions. For all purposes of this Guaranty, unless otherwise defined herein or unless the context otherwise requires, all terms used herein which are defined in the Agreement shall have the respective meanings given them in the Agreement.

When used in this Guaranty, all words in any gender, whether male, female or neuter, shall extend to include all genders that may be applicable in any particular context.

2. Guaranty.

2.1 Guarantor hereby unconditionally and irrevocably guarantees to Lender and all of the successors, endorsees, transferees and assigns of Lender, the prompt and complete payment when due (whether at the stated maturity, by acceleration or otherwise) of the Obligations, including, without limitation, the aggregate unpaid principal amount of, and accrued interest on, the Note and all other obligations and liabilities of Borrower now existing or hereafter incurred arising out of or in connection with the Agreement (all such indebtedness, obligations and liabilities being hereinafter called the "Guaranteed Obligations"), and Guarantor further agrees to pay any and all expenses which may be paid or incurred in collecting from Guarantor any or all of the Guaranteed Obligations and/or in enforcing any rights hereunder.

2.2 The obligations of Guarantor under this Guaranty shall be continuing, absolute and unconditional under any and all circumstances and shall be paid by Guarantor regardless of (a) the validity, regularity, legality or enforceability of any one or more of the Agreement, the Note, any of the Guaranteed Obligations or any collateral security or other guaranty therefor at any time or from time to time held by Lender; (b) any defense, offset or counterclaim which may at any time be available to or be asserted by Borrower or Guarantor (other than actual payment of a Guaranteed Obligation); or (c) any other event or circumstance whatsoever which may constitute, or might be construed to constitute, an equitable or legal discharge of a surety or a guarantor, it being the purpose and intent of the Guarantor that this Guaranty and the Guarantor's obligations hereunder shall remain in full force and effect and be binding upon Guarantor and its successors until the Guaranteed Obligations and the obligations of Guarantor under this Guaranty shall have been satisfied by payment in full (subject to Section 2.5). Notwithstanding any other provision of this Guaranty to the contrary, by its acceptance of this Guaranty, Lender agrees not to institute an action or proceeding to enforce this Guaranty unless (i) a petition, case or proceeding under Title 11 of the United States Code, as amended from time to time, is filed by Borrower or Guarantor or against Borrower by Guarantor or any Affiliate of Borrower or (ii) Lender has made a demand upon Borrower for delivery of the deed and other transfer documents set forth in Section __ of the Agreement and Borrower, Guarantor or any Affiliate shall interfere in any manner whatsoever with the delivery of such deed and other transfer documents to Lender in accordance with Section ____ of the **[Escrow Agreement]**, which interference shall, for purposes hereof, include, but shall not be limited to, the institution or filing of any action, case or proceeding before or by any court, administrative agency or arbitration panel by Borrower, Guarantor or any Affiliate seeking (x) to stay or enjoin, permanently or temporarily, the delivery of the deed and other transfer documents as identified in the **[Escrow Agreement]**, (y) to rescind, revoke, void, set aside or nullify, in whole or in part, any delivery of the deed or other transfer and other documents or (z) a declaratory judgment or other relief precluding, limiting or affecting Lender's rights under the Agreement, provided, however, nothing contained in part (ii) of this sentence shall entitle Lender to institute an action or proceeding pursuant to this Guaranty if Borrower shall file an action or proceeding against Lender for breach of the Agreement where the sole remedy sought by Borrower is money damages and where such action or proceeding is filed after delivery of the deed and other transfer documents as identified in this __________ Agreement to, or upon the order of Lender, pursuant to Section ____ of the **[Escrow Agreement]** **[and such proceeding is instituted against Lender after the latest to occur of (1) the expiration**

of any federal or state redemption or reinstatement period and (2) the expiration of any federal or state fraudulent conveyance or preferential transfer set-aside or avoidance period].

2.3 Guarantor hereby consents that, without the necessity of any reservation of rights against Guarantor and without notice to or assent by Guarantor, any demand for payment of any of the Guaranteed Obligations made by Lender may be rescinded by Lender and any of the Guaranteed Obligations continued, and/or the Guaranteed Obligations, or the liability of any party upon or for any part thereof, or any collateral security or guaranty therefor, may, from time to time, in whole or in part, be renewed, extended, amended, modified, accelerated, settled, compromised, subordinated, waived, surrendered or released by Lender, and/or the Agreement, the Note, any collateral security documents or other guaranties or documents in connection therewith may be amended, modified, supplemented or terminated, in whole or in part, as Lender may deem advisable from time to time, and/or any collateral security at any time securing the payment of the Guaranteed Obligations may be sold, exchanged, waived, surrendered or released, Guarantor remaining bound hereunder notwithstanding the occurrence of any of the foregoing. Lender shall not have any duty to protect, secure, perfect or insure any collateral security at any time securing the payment of the Guaranteed Obligations. This is a guaranty of payment and not merely of collection. Guarantor waives any requirement that Lender make any demand, commence suit or exercise any other right or remedy under the Agreement, Note or other document or instrument prior to enforcing its rights against Guarantor hereunder. Guarantor waives diligence, presentment, protest, demand for payment and/or notice of default or non-payment to or upon any of Borrower (except as otherwise provided for in the Agreement) or Guarantor with respect to the Guaranteed Obligations. When making any demand hereunder against Guarantor, Lender may, but shall be under no obligation to make a similar demand on any other guarantor, and any failure by Lender to make any such demand or to collect any payments from any such other guarantor or any release of such other guarantor shall not relieve Guarantor of its obligations and liabilities hereunder, and shall not impair or affect the rights and remedies, express or implied, or as a matter of law, of Lender against Guarantor. For the purposes hereof "demand" shall include the commencement and continuance of any legal proceedings.

2.4 Guarantor waives any and all notice of the creation, renewal, extension, modification or accrual of any of the Guaranteed Obligations and notice of or proof of reliance by Lender upon this Guaranty or acceptance of this Guaranty. The Guaranteed Obligations, and any of them, shall conclusively be deemed to have been created, contracted or incurred in reliance upon this Guaranty, and all dealings between Borrower or Guarantor and Lender shall likewise be conclusively presumed to have been had or consummated in reliance upon this Guaranty. Guarantor acknowledges receipt of a copy of the Agreement and the form of the Note.

2.5 This Guaranty shall continue to be effective, or be reinstated, as the case may be, if at any time, payment, or any part thereof, of any of the Guaranteed Obligations is rescinded or must otherwise be restored, reinstated or returned by Lender in connection with the insolvency, bankruptcy or reorganization of any Borrowers, or otherwise, all as though such payment had not been made.

3. No Subrogation. Guarantor expressly and irrevocably waives any and all rights of subrogation, reimbursement, indemnity, exoneration, contribution and any other claim which it may now or hereafter have against any Borrower or any other person directly or contingently liable for the Guaranteed Obligations guarantied hereunder, or against or with respect to any of Borrower's property (including, without limitation, property collateralizing its obligations to Lender), arising from the existence or performance of this Guaranty.

4. Representations and Warranties. Guarantor hereby represents and warrants that (a) Guarantor is **[a _________]** an individual whose principal residence **[chief executive officer/principal place of business]** is situated in and who is a domiciliary of the State of ___________; (b) Guarantor has full power, authority, legal capacity and legal right to execute, deliver and perform this Guaranty; (c) this Guaranty constitutes a legal, valid and binding obligation of Guarantor enforceable in accordance with its terms; (d) no consent of any person (including any trustee, guardian, conservator or similar officer for or holder of any obligations of Guarantor), and no consent, license, approval or authorization of, or registration or filing with, any governmental authority, bureau or agency is required in connection with the execution, delivery and performance of, and payment under, this Guaranty; (e) the execution, delivery, performance and payment of this Guaranty does not and will not contravene any applicable law, regulation, order or decree, or any provision of any indenture, mortgage, contract or other agreement to which Guarantor, or any person controlled by, controlling, or under common control with Guarantor, is a party or by which any of the same or any of their respective assets may be bound; (f) there is no action, suit, investigation or proceeding by or before any court, arbitrator, administrative agency or other governmental authority pending or threatened against or affecting Guarantor (A) which involves the Guaranteed Obligations or Guarantor's obligations under this Guaranty, or (B) which if adversely determined, could have a material adverse effect on the financial condition, business, prospects or operations of Guarantor; (g) all financial statements of Guarantor heretofore or hereafter furnished to Lender are complete and correct and fairly present the financial condition of Guarantor and the results of his businesses and affairs for the respective periods covered thereby, and there are no known contingent liabilities or liabilities for taxes of Guarantor which are not reflected in said financial statements and since the date of the most recent financial statements of Guarantor furnished to Lender, there has been no material adverse change in the financial condition, business, prospects or operations of Guarantor; and (h) Guarantor is not in default under any indenture, mortgage, contract or other agreement to which it is a party or by which Guarantor or any of its assets may be bound.

5. No Changes in Guarantor. Guarantor covenants and agrees that from and after the date hereof and so long as any of the Guaranteed Obligations remain outstanding, Guarantor will not (a) **[except as expressly permitted under subsection (c)]**, enter into any transaction or make any gift or devise or otherwise transfer any portion of Guarantor's assets unless after giving effect to such

transaction Guarantor's tangible net worth equals or exceeds that which existed prior to such transaction, gift, devise or other transfer; **[or]** (b) otherwise sell or otherwise dispose of all or any substantial part of Guarantor's assets; **[or (c) without limiting the generality of clause (b), sell, transfer or otherwise dispose of any stock of any of Borrower owned by him as of the date hereof, except for transfers of such stock to existing shareholders of the Borrower made consistent with past practices and of a value not greater during any year than the value of stock so transferred during any year before the date on which the Loan was made].**

6. Additional Covenants of Guarantor. Guarantor covenants and agrees that from and after the date hereof and so long as any of the Guaranteed Obligations remain outstanding, it will: (1) promptly give written notice to Lender of (i) the occurrence of any Event of Default under the Agreement of which it is or should be aware; (ii) the commencement or threat of any material litigation or proceedings affecting it; and (iii) any dispute between it and any governmental regulatory body or other party that might materially interfere with Guarantor's normal businesses and affairs; (2) (i) duly observe and conform to all requirements of any governmental authorities relating to the conduct of Guarantor's businesses and affairs or to Guarantor's properties or assets; (ii) keep in full force and effect all rights, franchises, licenses and permits which are necessary to the proper conduct of Guarantor's businesses and affairs; and (iii) obtain or cause to be obtained as promptly as possible any governmental, administrative or agency approval and make any filing or registration therewith which at the time shall be required with respect to the performance of Guarantor's obligations under this Guaranty or the operation of Guarantor's businesses and affairs; (3) on not less than two (2) Business Days' prior notice (which need not be in writing), permit Lender or Guarantor's authorized representative at any reasonable time or times following the occurrence and during the continuation of an Event of Default under the Agreement to inspect Guarantor's books and records; (4) keep proper books of record and account in which full, true and correct entries in accordance with generally accepted accounting principles will be made of all dealings or transactions in relation to Guarantor's businesses, affairs and other activities; and (5) furnish to Lender the following financial statements, all in reasonable detail, prepared in accordance with generally accepted accounting principles applied on a basis consistently maintained throughout the period involved and with prior periods certified as true, current complete by **[an independent certified public accounting firm of recognized national standing] [Guarantor] [Guarantor's chief financial officer]**, (a) as soon as available, but in any event not later than ten (10) days after Guarantor files his federal income tax return for each year, Guarantor's personal financial statements, in form acceptable to Lender; and (b) promptly furnish to Lender, such additional financial and other information as Lender may from time to time reasonably request.

[Guarantor acknowledges that it shall be an Event of Default under the Agreement if, after the death of the Guarantor, any one or more of the following occurs:

(A) **on or before the thirtieth day thereafter the estate of the Guarantor, by its appropriate representative, has not expressly assumed and reaffirmed the terms and provisions of the guaranty executed by the Guarantor and any security instruments executed and delivered with respect to the Guaranty, by executing and delivering to Lender instruments in form and substance acceptable to Lender;**

(B) **on or before the thirtieth day thereafter the estate of the Guarantor, by its appropriate representative, has not provided to Lender evidence reasonably acceptable to Lender of the solvency of said estate;**

(C) **on or before the thirtieth day thereafter the estate of the Guarantor, by Guarantor's appropriate representative, has not executed in favor of and delivered to Lender an agreement in form and substance acceptable to Lender pursuant to which it agrees to establish reserves reasonably sufficient to satisfy the estate's obligations under the Guaranty; or**

(D) **said estate at any time thereafter makes any payment or distribution the result of which would be to leave the estate without adequate reserves to satisfy its obligations under the Guaranty.]**

7. Notices. **[Make consistent with Loan Documents or Modification Documents]**.

8. No Waiver; Cumulative Remedies. A waiver by Lender of any right or remedy hereunder on any one occasion shall not be construed as a bar to any right or remedy which Lender would otherwise have had on any future occasion. No failure to exercise nor any delay in exercising on the part of Lender any right, power or privilege hereunder, shall operate as a waiver thereof; nor shall any single or partial exercise of any right, power or privilege hereunder preclude any other or further exercise thereof or the exercise of any other right, power or privilege. The rights and remedies herein provided are cumulative and may be exercised singly or concurrently, and are not exclusive of any rights and remedies provided by law.

9. Miscellaneous. None of the terms or provisions of this Guaranty may be amended, waived, altered, modified, or terminated except by an instrument in writing signed by the party against which enforcement of such amendment, waiver, alteration, modification or termination is sought. This Guaranty and all obligations of Guarantor hereunder shall be binding upon the

successors and assigns of Guarantor, and shall, together with the rights and remedies of Lender hereunder, inure to the benefit of Lender and its successors and assigns. The invalidity, illegality or indemnity of any provision of this Guaranty shall not affect the validity, legality or enforceability of any other provision of this Guaranty. THIS GUARANTY SHALL BE GOVERNED BY, AND BE CONSTRUED AND INTERPRETED IN ACCORDANCE WITH, THE LAWS OF THE STATE OF ______.

10. Waiver of Jury Trial**.** GUARANTOR HEREBY WAIVES GUARANTOR'S RIGHT TO A TRIAL BY JURY IN ANY ACTION OR PROCEEDING BASED UPON, OR RELATED TO, THE SUBJECT MATTER OF THIS GUARANTY AND THE BUSINESS RELATIONSHIP THAT IS BEING ESTABLISHED. THIS WAIVER IS KNOWINGLY, INTENTIONALLY AND VOLUNTARILY MADE BY GUARANTOR AND EACH GUARANTOR ACKNOWLEDGES THAT NEITHER LENDER NOR ANY PERSON ACTING ON BEHALF OF LENDER HAS MADE ANY REPRESENTATIONS OF FACT TO INDUCE THIS WAIVER OF TRIAL BY JURY OR HAS TAKEN ANY ACTIONS WHICH IN ANY WAY MODIFY OR NULLIFY ITS EFFECT. GUARANTOR ACKNOWLEDGES THAT THIS WAIVER IS A MATERIAL INDUCEMENT TO ENTER INTO A BUSINESS RELATIONSHIP, THAT GUARANTOR HAS ALREADY RELIED ON THIS WAIVER IN ACCEPTING THIS GUARANTY AND THAT LENDER WILL CONTINUE TO RELY ON THIS WAIVER IN ITS RELATED FUTURE DEALINGS. GUARANTOR FURTHER ACKNOWLEDGES THAT GUARANTOR HAS BEEN REPRESENTED (OR HAS HAD THE OPPORTUNITY TO BE REPRESENTED) IN THE SIGNING OF THIS GUARANTY AND IN THE MAKING OF THIS WAIVER BY INDEPENDENT LEGAL COUNSEL.

IN WITNESS WHEREOF, the undersigned has caused this Guaranty to be duly executed and delivered as of the day and year first above written.

Name: ________________________________

STATE OF _____)
) SS
COUNTY OF _________)

ACKNOWLEDGEMENT

I, ______________________________, a Notary Public, in and for said County, in the State aforesaid, DO HEREBY CERTIFY, that _______, personally known to me to be the same person whose name is subscribed to the foregoing instrument, appeared before me this day in person and acknowledged that he signed and delivered the said instrument as his own free and voluntary act and for the uses and purposes set forth therein.

GIVEN under my hand and Notarial seal this ____ day of _______________, 19___.

____
Notary Public

My commission expires:

__________________, 19__

EXHIBIT "B"

GUARANTY

1. The Guaranty. FOR VALUE RECEIVED and in consideration of advances made or to be made, or credit given or to be given, or other financial accommodation from time to time afforded or to be afforded to ____________________, a limited partnership organized and operated under the laws of the state of _______________ (the "Beneficiary") or to _______________ NATIONAL RANK AND TRUST COMPANY OF _______________ ("Trustee"), not personally but as Trustee under Trust Agreement dated __________, 199__ and known as Trust No. __________ (herein, Beneficiary and Trustee, individually and collectively, jointly and severally, together with the successors and assigns of each of them, are sometimes called "Debtor"), by ____________________, its successor or successors, immediate or remote, by merger, consolidation, sale of a major portion of its assets or otherwise (all of which are hereunder called "Lender"), and in consideration of Lender entering into the Settlement Agreement (defined hereinafter), the undersigned, ____________________ and ____________________ (individually, a "Guarantor," and collectively, "Guarantors"), jointly and severally hereby unconditionally guaranty (subject to the limitations set forth in Section 2 hereof) the full and prompt payment and performance when due (whether by acceleration or otherwise) to Lender of the Obligations (defined below). For all purposes of this Guaranty ("Guaranty"), the term "Obligations" shall mean and include all obligations and indebtedness (including, without limitation, all principal, Basic Interest, Additional Interest, costs, fees and expenses) of Debtor to Lender of any kind whatsoever, howsoever created, arising or evidenced, whether direct or indirect, absolute or contingent, now or hereafter existing, or due or to become due, under or with respect to any or all of the following:

a. An Amended and Restated Mortgage Note dated as of ____________ 199__, given by Debtor to Lender in the principal amount of $____________ (the "Note");

b. That certain Amended and Restated First Mortgage and Security Agreement (the "Mortgage") executed by Debtor, dated as of the date of the Note and recorded in the Office of the Recorder of Deeds of __________ County, __________ and covering certain property in __________ County, __________, more particularly described in the Mortgage (the "Mortgaged Premises");

c. That certain Security Agreement (Improvements Escrow, Consultant's Escrow, Cash Flow Escrow and Tax Escrow) executed by Debtor and dated of even date herewith;

d. All of the other Restated Loan and Mortgage Documents (as such term is defined in the Mortgage); and

e. The indemnity set forth in Section ___ of that certain Agreement dated as of ______, 199__ among Beneficiary, the Guarantors, _______________, _______________ Management Co., Inc., and _______________ (the "Settlement Agreement");

and any and all modifications, extensions or renewals of or substitutions for, any thereof or collateral given in connection with any thereof, heretofore or hereafter; and the term "Obligations" shall include all such obligations and indebtedness unconditionally, and notwithstanding any right or power of Debtor or anyone else to assert any claim or defense as to the invalidity or unenforceability of any of such obligations or indebtedness, and no such claim or defense shall affect or impair the obligations of Guarantors hereunder. Upon the occurrence of any Event of Default under any of the Restated Loan and Mortgage Documents, or upon any default or breach under the Settlement Agreement, Guarantors will, on demand by Lender or the holder of the Note, pay and perform all of the Obligations. Guarantors further agree to pay on demand all expenses, legal or otherwise (including court costs and attorneys' fees), paid or incurred by Lender in endeavoring to collect the Obligations, or any part thereof, and in enforcing this Guaranty.

2. Limitation on Guaranty. Notwithstanding anything to the contrary contained herein, Lenders' right of recovery and judgment against Guarantors is limited to: (a) $_________________ , plus all costs and expenses (including, without limitation, reasonable attorneys' fees) paid or incurred by Lender in endeavoring to collect on this Guaranty, or any part thereof, and in enforcing this Guaranty and Guarantors' obligations hereunder, plus (b) interest at the Default Rate provided in the Note, on such amounts as are described in clause (a) above at any time due and owing.

3. Covenant Not to Sue. Notwithstanding anything herein to the contrary, Lender covenants and agrees with Guarantors that Lender will not sue Guarantors, or assert any claims against Guarantors in respect of their obligations under this Guaranty, unless and until either (A) both a Conveyance Event (as defined in the Settlement Agreement) and a Challenge (defined hereinafter) have occurred or (B) a Claim (defined hereinafter) is raised which involves or includes the assertion that the transfer of the Mortgaged Premises (or any portion thereof) pursuant to the Escrow Agreement (as defined in the Settlement Agreement) and the Conveyance Documents (as defined in the Settlement Agreement) is or would be unenforceable under applicable law. For purposes of this Section, a "Challenge" shall mean (A) (i) the filing, institution or commencement of a voluntary bankruptcy proceeding by Beneficiary, or (ii) the filing, institution or commencement of an involuntary bankruptcy proceeding or any other action or proceeding against Beneficiary which involuntary proceeding or other such action or proceeding is not dismissed with prejudice within thirty (30) days of its commencement or (B) the filing, institution, commencement or assertion of any suit, cause of action, arbitration proceeding, claim, counterclaim, defense, or action of any kind other than a Permitted Challenge (defined hereafter) (each a "Claim") by any one or more of Beneficiary, Trustee, any Guarantor or any relative or affiliate of or entity controlling, controlled by or under common control with any of the foregoing (an "Affiliated Challenging Partv") or by any other person or entity other than an Affiliated Challenging Party (an "Unaffiliated Challenging Party") of, concerning, related to or in

any way connected with or arising from the Loan and Mortgage Documents (as defined in the Settlement Agreement) or the Restated Loan and Mortgage Documents or the Settlement Agreement, including (without limitation) a Claim (i) which is based, in whole or in part, on the claim, assertion, allegation or premise that a Conveyance Event (as defined in the Settlement Agreement) has not occurred or that Lender (or its designee) is not or was not entitled to obtain title to or ownership of the Mortgaged Premises (regardless of whether by conveyance as provided in the Escrow Agreement, by foreclosure or otherwise), (ii) which in any way challenges or contests, or seeks to impede, delay, bar, stay, enjoin, interfere with, rescind or invalidate, Lender (or its designees) obtaining title to or ownership of the Mortgaged Premises (regardless of whether by conveyance as provided in the Escrow Agreement, by foreclosure or otherwise), or (iii) which is based, in whole or in part, on the claim, assertion, allegation or premise that Lender has acted improperly or in bad faith or in breach of any of its obligations under any of the Restated Loan and Mortgage Documents, under the Settlement Agreement or otherwise. For purposes of this Section, a "Permitted Challenge" shall mean any Challenge (a) consisting of a lawsuit commenced by an Affiliated Challenging Party, in a court which has competent jurisdiction over the parties and the subject matter or of a claim. defense or counterclaim asserted in anv action brought by Lender, its successors or assigns, (b) where one of the claims or the only claim raised or asserted by the Challenging Party is that no Conveyance Event has occurred, (c) in which the court enters a final and nonappealable order or judgment finding that no Conveyance Event has in fact occurred, and (d) involves an assertion that the remedies set forth in Sections ___, ___ and ___ of the Settlement Agreement pertaining to the transfer of the Mortgaged Premises (or any portion thereof) pursuant to the Conveyance Documents are not enforceable remedies as a matter of law.

4. Reliance. It is expressly understood and acknowledged that Lender has entered into the Settlement Agreement in reliance upon the agreement contained therein of Guarantors to enter into this Guaranty, and that Lender has made financial accommodations in reliance upon the execution and delivery of this Guaranty and the validity thereof, and Guarantors have consented to this Guaranty as an inducement to Lender to enter into the Settlement Agreement.

5. Representations and Warranties. Each Guarantor represents and warrants to Lender as follows:

a. Any and all balance sheets, net worth statements and other financial statements or data concerning Guarantors which have heretofore been given to Lender by or on behalf of such Guarantor fairly and accurately present, to the best knowledge, information and belief of the Guarantors, the financial condition of Guarantors as of the respective dates thereof, and, since the respective dates thereof, there has been no material adverse change in the financial condition of Guarantors.

b. The execution, delivery and performance of this Guaranty by Guarantors and the performance of all covenants, agreements and obligations hereunder do not and will not contravene or conflict with (i) the limited partnership agreement of Beneficiary, (ii) any law, order, rule, regulation, writ, injunction, or decree now in effect of any government, governmental instrumentality or court having

jurisdiction over Guarantors, or (iii) any contractual restriction binding on or affecting Guarantors or their respective property or assets.

c. This Guaranty constitutes the legal, valid and binding obligation of Guarantors and is enforceable against Guarantors in accordance with its terms.

d. Except as previously disclosed in writing or under oath by Guarantors to Lender, there is no action, proceeding or investigation pending or, to the knowledge of such Guarantor, threatened or affecting Guarantors which may adversely affect Guarantors' ability to fulfill Guarantors' obligations under this Guaranty.

e. Guarantors have disclosed all events, conditions and facts known to Guarantors which could have any material adverse effect on the financial condition of Guarantors. No representation or warranty of Guarantors contained herein, nor any schedule, certificate or other document furnished by Guarantors to Lender in connection with this Guaranty or the Restated Loan and Mortgage Documents or the Settlement Agreement, contains any material misstatement of fact or omits to state a material fact or any fact necessary to make the statements contained therein not misleading.

g. Except as previously disclosed to Lender in writing or under oath, there are no facts or circumstances of any kind or nature whatsoever of which such Guarantor is aware which such Guarantor believes would in any way impair or prevent Guarantors from performing their obligations under this Guaranty in any material respect.

6. Covenants. Each Guarantor agrees and covenants as follows:

a. Guarantors agree that this Guaranty shall continue to be effective or be reinstated, as the case may be, if at any time payment or performance of any of the Obligations, or any part thereof, is avoided, rescinded or waived, or must otherwise be restored, disgorged, reimbursed or repaid by Lender upon the bankruptcy, insolvency or reorganization of Debtor or otherwise and shall continue in full force and effect as long as there exists a possibility that any payment or performance of any of the Obligations may be avoided, rescinded, waived, restored, disgorged, reimbursed or repaid. without limiting the generality of the foregoing, Guarantors agree that to the extent Debtor makes a payment or payments to Lender, which payment or payments or any part thereof are at any time subsequently invalidated, declared to be fraudulent or preferential, set aside or required, for any of the foregoing reasons or for any other reason, to be repaid or paid over to a custodian, trustee, receiver, or any other party under any bankruptcy code or act, state or federal law, common law or equitable cause, then to the extent of such payment or repayment, the Obligations or any part thereof intended to be satisfied shall be revived and continued in full force and effect as if

said payment or repayment had not been made and Guarantors shall be primarily liable for such Obligations.

b. Lender may, from time to time, in its sole discretion and without notice to or consent by Guarantors, take any or all of the following actions, all without in any way diminishing, impairing, releasing or affecting the liability or obligations of Guarantors under or with respect to this Guaranty (and each Guarantor hereby irrevocably consents to Lender doing any or all of the following): (i) retain or obtain a security interest in any property to secure any of the Obligations or any obligation hereunder (provided that nothing in this clause (i) shall otherwise obligate Guarantors to grant any security interest to Lender in any property of Guarantors), (ii) retain or obtain the primary or secondary obligation of any obligor or obligors, in addition to Guarantors, with respect to any of the Obligations, (iii) extend or renew for one or mqre periods (whether or not longer than the original period), or alter or exchange, any of the Obligations, or release or compromise any obligation of Guarantors hereunder or any obligation of any nature of any other obligor with respect to any of the Obligations, or otherwise amend or modify any or all of the Restated Loan and Mortgage Documents or the Settlement Agreement, (iv) waive, modify, subordinate, compromise or release its security interest in, or surrender, release or permit any substitution or exchange for, all or any part of any property securing any of the Obligations or any obligation hereunder, or extend or renew for one or more periods (whether or not longer than the original period) or waive, release, subordinate, compromise, modify, alter or exchange any obligations of any nature of any obligor with respect to any such property, (v) subject to <u>Section 3</u> hereof, resort to Guarantors for payment of any of the Obligations, whether or not Lender shall have resorted to or exhausted any other remedy or any other security or collateral or any obligation hereunder or shall have proceeded against Beneficiary or any other obligor primarily or secondarily obligated with respect to any of the Obligations, and (vi) grant participations to one or more banks or other financial institutions in and to all or any part of the Note, the Mortgage and the other Restated Loan and Mortgage Documents and the indebtedness evidenced thereby, this Guaranty, or other security documents now or hereafter in existence with respect to the Obligations.

c. No act of commission or omission of any kind or at any time, upon the part of Lender in respect to any matter whatsoever, shall in any way affect or impair this Guaranty.

d. So long as any of the Restated Loan and Mortgage Documents or the Settlement Agreement shall be in effect or any of the obligations shall be owed by Debtor, each Guarantor covenants that:

(1) Such Guarantor will deliver to Lender from time to time, but in no event less than one time per year, on or before April 14 of each year (or within 10 days after any permitted extension of the filing date for such taxes), a financial statement certified as accurate by such Guarantor and copies of such Guarantor's federal and state tax returns and such other information regarding the financial position or business of Guarantors as Lender may reasonably request;

(2) Guarantors will promptly give notice in writing to Lender of all litigation, arbitration proceedings and regulatory proceedings affecting Guarantors or any of them or any of their properties, which reasonably could be expected materially and adversely to affect the financial condition or business of Guarantors in their respective individual capacities or any of them or the ability of Guarantors or any of them to perform the obligations under this Guaranty or which in any manner draws into question the validity of the Restated Loan and Mortgage Documents, the Settlement Agreement or the Obligations; and

(3) Guarantors agree to provide from time to time such other information concerning Guarantors as Lender may reasonably request.

e. Any amounts received by Lender from whatever source on account of the Obligations may be applied by it toward the payment of such of the Obligations, and in such order, portion and priority of application, as Lender may from time to time elect in its sole and absolute discretion.

f. Any indebtedness of Debtor now or hereafter held by or owing to either of the Guarantors is hereby subordinated to the indebtedness of Debtor to Lender under to either Guarantor on account of any subordinated debt (other than payments made on the Working Capital Loan as permitted by the Deposits Security Agreement) shall be collected and received by such Guarantor in trust for Lender and shall be paid over to Lender on account of the Indebtedness (as defined in the Note) without impairing or releasing the obligations of Guarantors hereunder.

g. The liability of Guarantors hereunder, and the remedies for the enforcement of such liability, shall in no way be diminished or affected by (i) the release or discharge of Debtor in any creditors', receivership, bankruptcy, reorganization, insolvency or other proceeding, (ii) the rejection or disaffirmance of any document or instrument evidencing, securing, or executed in connection with the Obligations in any such proceeding, (iii) the impairment, limitation or modification of the Obligations or of the estate of Debtor in bankruptcy, or of any remedy for the enforcement of Debtor's liability under any document or instrument evidencing, securing, or executed in connection with the Obligations, resulting from the operation of any present or future provision of title 11 of the United States Code or

any other statute or law of any kind or from the decision or order of any court, (iv) any disability or defense of Debtor, or (v) the cessation of the liability of Debtor for any cause whatsoever.

h. The creation or existence from time to time of Obligations in excess of the amount to which the right of recovery under this Guaranty is limited is hereby authorized and permitted, without notice to Guarantors, and shall in no way affect or impair the rights of Lender and the obligations of Guarantors under this Guaranty.

i. Lender shall have no obligation of any kind whatsoever to obtain, perfect or retain a valid lien upon or security interest in any collateral of any kind whatsoever to secure any of the Obligations, or to protect or insure any property which may at any time be the subject of any such lien or security interest, and any failure of Lender to obtain, perfect or retain any such lien or security interest, or to protect or insure any such property, shall in no way impair, diminish, release or affect the obligations of Guarantors hereunder.

j. It is further expressly understood by and between Lender and Guarantors that Guarantors' personal guaranty referred to herein shall not in any way modify or relieve Guarantors of or from any other liability or obligations that Guarantors or any of them may have to Lender relative to any and all documents executed by Guarantors or any of them, including the Restated Loan and Mortgage Documents and the Settlement Agreement, and that any and all said liability shall survive the execution of this Guaranty, and shall remain in full force and effect subsequent to this Guaranty.

k. In order to hold Guarantors liable hereunder (subject to Section 3 hereof), there shall be no obligation on the part of Lender, at any time, to resort for payment to Debtor or other persons or corporations, their properties or estates, or resort to any collateral, security, property, liens or other rights or remedies whatsoever, it being understood that this is a guaranty of payment and performance and not of collection.

l. In the event this Guaranty is executed by more than one person or entity, it is agreed that each shall be bound by all of the provisions hereof, jointly and severally, and, subject to the limitations set forth in Section 2 and Section 3, each shall be obligated for the full payment of the Obligations to Lender, regardless of the existence of any such other guaranty. If more than one Debtor is named herein, this Guaranty shall extend fully to the indebtedness of each such Debtor to Lender.

m. If acceleration of the time for payment of any amount that is guarantied hereunder is stayed or demand for payment of any such amount is precluded upon the insolvency, bankruptcy or reorganization of Debtor (determined without regard to whether a court might act favorably on a request for relief from any such stay or

other preclusion), all such amounts otherwise subject to acceleration under the terms of the Restated Loan and Mortgage Documents shall nonetheless be payable by Guarantors hereunder forthwith on demand by Lender.

n. Such Guarantor shall, within five (5) business days after receipt thereof, deliver to Lender copies of any notices of default served on such Guarantor in his individual capacity pursuant to the terms of any other agreement to which either Guarantor is a party where such agreement involves goods, services or obligations with respect to which the fair market value or stated price or value exceeds $10,000.00.

7. Waivers. Each Guarantor hereby expressly waives:

c. notice of the acceptance by Lender of this Guaranty,

d. notice of the existence or creation or non-payment of all of any of the Obligations,

c. presentment, demand, notice of dishonor, protest, notice of protest, default, nonpayment, and all other notices whatsoever,

d. all diligence in collection or protection of or realization upon the Obligations or any thereof, any obligation hereunder, or any security for or guaranty of any of the foregoing,

e. any right of subrogation against Debtor, except as provided in Section 23,

f. its right to enforce any remedies Lender now has, or later may have, against Debtor, except as provided in Section 24,

g. any right to participate in any~security now or hereafter held by Lender, except as provided in Section 23, and

h. all suretyship defenses and suretyship rights of every nature otherwise available.

8. Effect of Delay or Action. No delay on the part of Lender in the exercise of any right or remedy shall operate as a waiver thereof, and no single or partial exercise by Lender of any right or remedy shall preclude other or further exercise thereof or the exercise of any other right or remedy, nor shall any modification or waiver of any of the provisions of this Guaranty be binding upon Lender except as expressly set forth in a writing duly signed and delivered on behalf of Lender. No action of Lender permitted hereunder shall in any way affect or impair the rights of Lender or the obligations of Guarantors under this Guaranty.

9. Successors and Assigns: Participations. All of the representations, warranties, undertakings, agreements and covenants herein contained and the obligations hereunder shall be binding upon Guarantors and their respective heirs, executors and legal and personal representatives, and upon their respective successors and assigns; and to the extent that Debtor or any Guarantor is either a partnership or a corporation, all references herein to Debtor and to such Guarantor, respectively, shall be deemed to include any and all successors, whether immediate or remote, to such partnership or corporation. Lender may, without any notice whatsoever to anyone, sell, assign or transfer all of the Restated Loan and Mortgage Documents or the obligations, or any part thereof, and in that event each and every immediate and successive assignee, transferee, or holder of all or any part of the Restated Loan and Mortgage Documents or the obligations shall have the right to enforce this Guaranty, by suit or otherwise, for the benefit of such assignee, transferee or holder, as fully as if such assignee, transferee or holder were herein by name specifically given such rights, powers and benefits; but Lender shall have an unimpaired right, prior and superior to that of any said assignee, transferee or holder, to enforce this Guaranty for the benefit of Lender, as to so much of the Restated Loan and Mortgage Documents or the Obligations as it has not sold, assigned or transferred.

10. Continuing and Unconditional Guaranty. This Guaranty shall in all respects be a continuing, absolute, irrevocable and unconditional guaranty, and shall remain in full force and effect (notwithstanding, without limitation, the death, withdrawal, bankruptcy, dissolution or termination of the existence of Debtor or of any Guarantor) until all of the following have occurred: (i) Guarantors have no further monetary obligation of any kind under or with respect to this Guaranty, (ii) all of Guarantors' obligations hereunder (including, without limitation, costs of collection hereunder) have been paid and satisfied in full, (iii) Lender has no further obligation to make any advance or extend any credit under any agreement to which this Guaranty would apply, and (iv) all indebtedness and other amounts owed by Beneficiary or Trustee under the Restated Loan and Mortgage Documents or the Settlement Agreement have been paid in full. No notice of discontinuance given by the Guarantors shall affect or impair any of the agreements or obligations of Guarantors hereunder, and all of the agreements and obligations of Guarantors under this Guaranty shall, notwithstanding any notice of discontinuance, remain fully in effect until the conditions set out in the preceding sentence have been satisfied.

11. No Exculpation. No exculpatory, “non-recourse” or other language or provision contained in the Settlement Agreement, the Note or in any other document or instrument shall in any way prevent or limit Lender from proceeding to enforce this Guaranty against Guarantors personally. It is further expressly understood by and between Lender and Guarantors that Guarantors' personal guaranty referred to herein shall not in any way modify or relieve Guarantors of or from any other liability or Qbligations that Guarantors or any of them may have to Lender relative to any and all documents executed by Guarantors or any of them, including the Restated Loan and Mortgage Documents or the Settlement Agreement, and that any and all said liability shall survive the execution of this Guaranty, and shall remain in full force and effect subsequent to this Guaranty.

12. Mortgage on Real Property. Each Guarantor authorizes Lender, at its sole option, without notice or demand and without affecting the liability of Guarantors hereunder, to release and reconvey (with or without the receipt of any consideration) any lien against any or all of the security, and to foreclose the Mortgage by judicial sale, or to accept a conveyance of the Mortgaged Premises, all without affecting the liability of Guarantors hereunder. Each Guarantor expressly waives any defense to the recovery by Lender from such Guarantor of any deficiency, including without limitation any defense arising as a result of any election of remedies by Lender which limits or destroys Guarantors' right to proceed against Debtor. Each Guarantor waives all suretyship defenses it would otherwise have. Each Guarantor waives any right to receive notice of any judicial sale or foreclosure or conveyance of any real property, and the failure of Guarantors to receive such notice shall not impair or affect Guarantors' liability hereunder.

13. Guarantv of Payment. In order to hold Guarantors liable hereunder (subject to Section 3 hereof), there shall be no obligation on the part of Lender, at any time, to resort for payment to Debtor, or other persons or corporations, their properties or estates, or resort to any collateral, security, property, liens or other rights or remedies whatsoever. The obligations of Guarantors hereunder are independent of the obligations of Debtor, notwithstanding any right or power of the Debtor or any other person or entity to assert any claim or defense as to the invalidity or unenforceability of the Obligations or of any provision of the Settlement Agreement, the Restated Loan and Mortgage Documents or the Conveyance Documents, and no such claim or defense shall impair the obligations of the undersigned hereunder. A separate action may be brought and prosecuted against Guarantors, and any requirement that Lender institute suit, or exercise or exhaust its remedies or rights against Debtor or against any other person, guarantor, or mortgage, or other collateral guaranty securing all or any part of the Obligations, prior to enforcing any rights it has under this Guaranty, or otherwise, is hereby expressly waived, and Guarantors hereby further waive the benefit of any statute of limitations affecting their liability hereunder or the enforcement hereof. Guarantors agree that their liability hereunder is primary, absolute and unconditional without regard to the liability of any other party, it being understood that (subject to Section 3 hereof) this Guaranty is a guaranty of payment and performance and not of collection.

14. Time of Essence. Time is of the essence of this Guaranty.

15. No Modification Without Writing. This Guaranty may not be modified, amended, revised, revoked, terminated, changed or varied in any way whatsoever except by the express terms of a writing signed by the party or parties sought to be bound thereby.

16. Rights Cumulative. The rights and remedies of Lender hereunder are cumulative and in addition to any and all other rights and remedies specified herein or in the Restated Loan and Mortgage Documents or in the Settlement Agreement or available at law or in equity.

17. Knowledge and Information. Guarantors, and each of them, are fully aware of the financial condition of Debtor (and the partners thereof) and of the Mortgaged Premises, and are executing and delivering this Guaranty based solely upon their own independent investigation of all matters pertinent hereto and are not relying in any manner upon any representation or statement of Lender with respect thereto. Guarantors are in a position to obtain, and hereby assume full responsibility for obtaining, any additional information concerning the financial condition of Debtor (and the partners thereof) and of the Mortgaged Premises as Guarantors may deem material to their obligations hereunder, and Guarantors are not relying upon, nor expecting, Lender to furnish them any information concerning the financial condition of Debtor (or the partners thereof) or the Mortgaged Premises. Guarantors shall have no right to require Lender to obtain or disclose any information with respect to the Obligations, the financial condition or character of Debtor (or the partners thereof) or the Mortgaged Premises, or Debtor's (or the partners' thereof) ability to pay the obligations or any other person, or any other matter, fact or occurrence whatsoever.

18. GOVERNING LAW. THIS GUARANTY SHALL BE CONSTRUED ACCORDING TO THE LAWS OF THE STATE OF _______________, IN WHICH STATE IT SHALL BE PERFORMED BY GUARANTORS. GUARANTORS AND LENDER HEREBY AGREE THAT ALL ACTIONS TO ENFORCE THE TERMS AND PROVISIONS OF THIS GUARANTY SHALL BE BROUGHT AND MAINTAINED ONLY WITHIN THE STATE OF _______________ AND GUARANTORS AND LENDER HEREBY CONSENT TO THE EXCLUSIVE JURISDICTION OF ANY COURT WITHIN THE STATE OF _______________, WAIVE PERSONAL SERVICE OF ALL PROCESS AND HEREBY CONSENT THAT SUCH SERVICE MAY BE MADE BY REGISTERED OR CERTIFIED MAIL, DIRECTED TO GUARANTORS OR TRAVELERS (AS THE CASE MAY BE), AT THE RESPECTIVE ADDRESSES HEREINAFTER SET FORTH. GUARANTORS, JOINTLY AND SEVERALLY, HEREBY EXPRESSLY WAIVE, AND LENDER HEREBY EXPRESSLY WAIVES, ANY AND ALL RIGHTS WHICH THEY OR IT MAY HAVE TO MAKE ANY OBJECTIONS BASED ON (A) JURISDICTION, TO ANY SUIT BROUGHT TO ENFORCE THIS GUARANTY IN THE STATE OF _______________, OR (B) VENUE, TO ANY SUIT BROUGHT TO ENFORCE THIS GUARANTY IN _______________ COUNTY, _______________, IN EACH CASE IN ACCORDANCE WITH THE ABOVE PROVISIONS.

19. Notices. Any notice, demand or other communication to be given hereunder shall be effectively given if made in writing, and delivered either personally or by United States certified or registered mail, postage prepaid, return receipt requested (which shall be deemed received upon the earlier of receipt or three (3) days after the deposit thereof with the United States Postal Service) to Lender or Guarantors (and their respective counsel) at their respective addresses set forth below or to such other addresses as Lender or Guarantors may direct in a notice complying with this Section:

Lender: ______________________

____

____

Attn: _______________

With a copy to: __________________
____
____

Guarantors: ___________________
____
____

and

____
____

With a copy to: __________________
____
____

20. Severability. If any provision of this Guaranty or the application thereof to any person or circumstance shall, to any extent, be invalid or unenforceable, the remainder of this Guaranty shall be valid and enforceable to the fullest extent permitted by law.

22. WAIVER OF JURY TRIAL. EACH GUARANTOR WAIVES ANY RIGHT TO A TRIAL BY JURY IN ANY ACTION OR PROCEEDING IN CONNECTION WITH THIS GUARANTY OR THE OTHER RESTATED LOAN AND MORTGAGE DOCUMENTS OR THE SETTLEMENT AGREEMENT OR ANY DOCUMENT REFERENCED THEREIN OR EXECUTED AND DELIVERED IN CONNECTION THEREWITH.

22. Capitalized Terms. Any term capitalized but not specifically defined herein, which is capitalized and defined in the Note, shall have the same meaning for purposes of this Guaranty as it has for purposes of the Note.

23. Subrogation. Notwithstanding anything to the contrary in this Guaranty, the waivers contained in sections 7(e), (f) and (g) shall apply only until all of the Obligations and the Guaranty have been satisfied in full.

SIGNED AND DELIVERED by the undersigned Guarantors, as of the _______________________ day of ___________________, 199__.

By: ___________________________,

Name: ____________________________,
Individually as Guarantor

By: ____________________________,

Name: ____________________________,
Individually as Guarantor

Accepted this _____ day of ______,19__

By: ____________________________ ("Lender")

By: ____________________
Name: ____________________
Title: ____________________

STATE OF ___________________)
) SS.
COUNTY OF _________________)

Before me, a Notary Public in and for said County and State, personally appeared ____, and acknowledged the execution of the foregoing "Guaranty" as his voluntary act and deed.

WITNESS my hand and Notarial Seal this ______ day of _____________________ 19

____
Notary Public

____
(Printed Signature)

My Commission Expires: _____________________

My County of Residence: _____________________

STATE OF ___________________)
) SS.
COUNTY OF _________________)

Before me, a Notary Public in and for said County and State, personally appeared ____, and acknowledged the execution of the foregoing "Guaranty" as his voluntary act and deed.

WITNESS my hand and Notarial Seal this ______ day of _____________________ 19

____
Notary Public

____

(Printed Signature)

My Commission Expires: _____________________

My County of Residence: _____________________

EXHIBIT "C"

INDEMNIFICATION AGREEMENT

THIS INDEMNIFICATION AGREEMENT dated as of the _____ day of _________, 199__ given by __________________________ and __________________________ (hereinafter collectively referred to as the "Indemnitors, and individually as an Indemnitor") to __________________________, a _______________ corporation having an office at ____________________, ____________________ (hereinafter referred to as "Lender").

PRELIMINARY STATEMENT

A. Unless otherwise defined in this Agreement, each capitalized term appearing in this Agreement shall have the meaning given to such term in Exhibit A, which is attached hereto and incorporated herein by reference.

B. Lender has made a loan (the "Loan") in the aggregate original principal amount of ____________________ and 00/100 Dollars ($_______________) to Borrower, which Loan is (i) evidenced by the Note and (ii) secured by, among other things, (a) the Mortgage covering the fee estate of Borrower in the Property, (b) the Assignment of Leases and Rents; and (c) the UCC-l Financing Statements.

C. At the request of Borrower and all of its partners, Lender has agreed to enter into the Modification and Extension Agreement, pursuant to which the Note, the Mortgage, the Assignment of Rents, the Assignment of Leases and the Cash Management Agreement will be modified and amended in certain respects, provided that, among other things, the Indemnitors enter into this Agreement. The Note, the Mortgage, the Assignment of Leases and Rents, the Pre-workout Agreement and all other documents and instruments executed and/or delivered in connection with the Loan, as the same may be modified, are hereinafter collectively referred to as the "Loan Documents").

D. Execution and delivery of this Agreement is a condition precedent to the effectiveness of the Modification and Extension Agreement.

NOW, THEREFORE, in consideration of the premises and other good and valuable consideration, the receipt and sufficiency of which are hereby acknowledged, and in order to induce Lender to enter into the Modification and Extension Agreement, the Indemnitors hereby covenant and agree with Lender as follows:

1. The Indemnitors absolutely and unconditionally agree to indemnify and to hold Lender harmless from and against any and all losses, claims, liabilities, damages, costs and expenses (including, without limitation, reasonable counsel fees) of any nature whatsoever, contingent or otherwise, foreseen or unforeseen, which Lender may or shall incur as a direct or indirect result of Borrower, any general partner of Borrower, any Indemnitor, any other person, party or entity (other than Lender) acting on behalf of or at the instigation of Borrower, any general partner of Borrower or any Indemnitor, or any other person, party or entity taking any step or action (including, without limitation, the filing by or against Borrower, or any general partner of Borrower, of a petition under any bankruptcy or insolvency law, which has the effect of materially interfering with, preventing, hindering or delaying the conveyance of the Property (whether by foreclosure or deed in lieu thereof) to Lender (or its nominee, assignee or designee) in accordance with the Loan Documents and any of the documents referred to therein or related thereto.

2. In the event that one of the events described in Paragraph 1 of this Agreement shall occur, the Indemnitors (a) acknowledge that the damage to be suffered by Lender shall be difficult or impossible to ascertain and (b) absolutely and unconditionally agree to pay to Lender upon demand the sum of ____________________ and 00/100 Dollars ($_______________) as full liquidated damages for, and in satisfaction of, the Indemnitors' obligations hereunder as Lender's sole and exclusive remedy hereunder. The Indemnitors acknowledge and agree that the payment of the aforesaid ____________________ and 00/100 Dollars ($_______________) is a fair and reasonable remedy for Lender if any of the events set forth in Paragraph 1 of this Indemnification Agreement shall occur, as any such event will result in Lender incurring damages which cannot now be determined with any degree of certainty.

3. The Indemnitors hereby consent that from time to time, before or after any default by Borrower, with or without further notice to or assent from the Indemnitors, any security at any time held by or available to Lender for any obligation of Borrower, or any security at any time held by or available to Lender for any obligation of any other person or party secondarily or otherwise liable for all or any portion of the Debt may be exchanged, surrendered or released and any obligation of Borrower, or of any such other person or party, may be changed, altered, renewed, extended, continued, surrendered, compromised, waived or released in whole or in part, or any default with respect thereto waived, and Lender may fail to set off and may release, in whole or in part, any balance of any deposit account or credit on its books in favor of Borrower, or of any such other person or party, and may extend further credit in any manner whatsoever to Borrower, and generally deal with Borrower or any such security or other person or party as Lender may see fit; and the Indemnitors shall remain bound under this Indemnification Agreement notwithstanding any such exchange, surrender, release, change, alteration, renewal, extension, continuance, compromise, waiver, inaction, extension of further credit or other dealing.

4. This is an agreement to pay liquidated damages and not an agreement of collection and the Indemnitors further waive any right to require that any action be brought against Borrower or any other person or party or to require that resort be had to any security or to any balance of any deposit account or credit on the books of Lender in favor of Borrower or any other entity, person or party.

5. Each reference herein to Lender shall be deemed to include its successors and assigns, in whose favor the provisions of this Indemnification Agreement shall also inure. This Indemnification Agreement shall be binding upon, and shall inure to the benefit of, Lender and the Indemnitors and the respective heirs, executors, administrators, legal representatives, successors and assigns of Lender and the Indemnitors, provided, however, that the Indemnitors shall in no event or under any circumstances have the right, without obtaining the prior written consent of Lender, to assign or transfer the Indemnitors' obligations and liabilities under this Indemnification Agreement, in whole or in part, to any other person, party or entity.

The term "Indemnitors" as used herein shall mean the "Indemnitors and each of them" and each undertaking herein contained shall be their joint and several undertaking, provided, however, that in the next succeeding paragraph hereof the term "Indemnitors" shall mean the "Indemnitors or any of them".

1. No delay on the part of Lender in exercising any right or remedy under this Indemnification Agreement or failure to exercise the same shall operate as a waiver in whole or in part of any such right or remedy. No notice to or demand on the Indemnitors shall be deemed to be a waiver of the obligation of the Indemnitors or of the right of Lender to take further action without notice or demand as provided in this Indemnification Agreement.

2. This Indemnification Agreement may only be modified, amended, changed or terminated by an agreement in writing signed by Lender and all of the Indemnitors. No waiver of any term, covenant or provision of this Indemnification Agreement shall be effective unless given in writing by Lender and if so given by Lender shall only be effective in the specific instance in which given.

3. The Indemnitors acknowledge that this Indemnification Agreement and the Indemnitors' obligations under this Indemnification Agreement are and shall at all times continue to be absolute and unconditional in all respects. This Indemnification Agreement sets forth the entire agreement and understanding of Lender and the Indemnitors, and the Indemnitors absolutely, unconditionally and irrevocably waive any and all right to assert any setoff, counterclaim or crossclaim of any nature whatsoever with respect to this Indemnification Agreement or the obligations of the Indemnitors under this Indemnification Agreement or the obligations of any other person or party (including, without limitation, Borrower) relating to this Indemnification Agreement or the obligations of the Indemnitors hereunder, in any action or proceeding brought by Lender to enforce the obligations of the Indemnitors under this Indemnification Agreement. The Indemnitors acknowledge and Lender, by its acceptance hereof, acknowledges that no oral or other agreements, understandings, representations or warranties exist

with respect to this Indemnification Agreement or with respect to the obligations of the Indemnitors under this Indemnification Agreement except as specifically set forth in this Indemnification Agreement or otherwise in writing by Lender and the Indemnitors.

4. Notwithstanding any payments made by the Indemnitors pursuant to the provisions of this Indemnification Agreement, the Indemnitors shall not seek to enforce or collect upon any rights which the Indemnitors now have or may acquire against Borrower either by way of subrogation, indemnity, reimbursement or contribution for any amount paid under this Indemnification Agreement. In the event either a petition is filed under the Bankruptcy Code or under any other applicable Federal or state bankruptcy law or other similar law in regard to Borrower or an action or proceeding is commenced for the benefit of the creditors of Borrower, this Indemnification Agreement shall at all times thereafter remain effective (or if previously terminated as a result of Indemnitors having fulfilled their obligations hereunder in full or as a result of Lender having released the Indemnitors from their obligations and liabilities hereunder, shall without further act or instrument be reinstated and shall thereafter remain in full force and effect), all in regard to any payments or other transfers of assets to Lender received from or on behalf of Borrower which are or may be held voidable on the grounds of preference, fraudulent conveyance or otherwise, whether or not the Debt has been paid in full with the same force and effect as if such payments or other transfer of assets had not been made, and if applicable, as if such previous termination had not occurred. Nothing contained in this paragraph shall be construed to increase the maximum liability of the Indemnitors hereunder to an aggregate amount in excess of ____________________ and 00/100 Dollars ($_______________), it being expressly understood that if the Indemnitors shall have paid all amounts due and owing hereunder, this Indemnity shall not be reinstated except in accordance with the provisions of paragraph 11 hereof.

5. If at any time any payment, or portion thereof, made by, or for the account of, the Indemnitors on account of the obligations under this Indemnification Agreement, is set aside by any court or trustee having jurisdiction as a voidable preference, fraudulent conveyance or otherwise as being subject to avoidance or recovery under the provisions of the Bankruptcy Code or under any other applicable Federal or state bankruptcy law or similar law, the Indemnitors hereby agree that this Indemnification Agreement (i) shall continue and remain in full force and effect, or (ii) if previously terminated as a result of the Indemnitors having fulfilled their obligations hereunder in full or as a result of Lender having released the Indemnitors from their obligations and liabilities hereunder, shall without further act or instrument be reinstated and shall thereafter remain in full force and effect, in either case with the same force and effect as though such payment or portion thereof had not been made, and if applicable, as if such previous termination had not occurred.

6. Any notice, request or demand given or made under this Indemnification Agreement shall be in writing and shall be hand delivered or sent by Federal Express or other reputable overnight national courier service, and shall be deemed given when received at the following addresses whether hand delivered or sent by Federal Express or other reputable overnight national courier service:

If to Lender: ________________________

____
____

Attention: ______________________

With a copy to:

____
____
____

Attention: ______________________

If to the Indemnitors:

____
____
____

Attention: _______________________

With a copy to:

____

____
____

Each party to this Indemnification Agreement may designate a change of address by notice given to the other party fifteen (15) days prior to the date such change of address is to become effective.

7. This Indemnification Agreement is, and shall be deemed to be, a contract entered into under and pursuant to the laws of the State of _______________ and shall be in all respects governed, construed, applied and enforced in accordance with the laws of the State of _______________. No defense given or allowed by the laws of any other state or country shall be interposed in any action or proceeding hereon unless such defense is also given or allowed by the laws of the State of _______________.

8. The Indemnitors agree to submit to personal jurisdiction in the State of _______________ in any action or proceeding arising out of this Indemnification Agreement and, in furtherance of such agreement, the Indemnitors hereby agree and consent that without limiting other methods of obtaining jurisdiction, personal jurisdiction over the Indemnitors in any such action or proceeding may be obtained within or without the jurisdiction of any court located in _______________ and that any process or notice of motion or other application to any such court in connection with any such action or proceeding may be served upon the Indemnitors, by registered or certified mail to or by personal service at the last known address of the Indemnitors, whether such address be within or without the jurisdiction of any such court.

9. No exculpatory provisions contained in the Note, the Mortgage or in any other document or instrument executed and delivered in connection therewith or otherwise with respect to the Debt shall in any event or under any circumstances be deemed or construed to modify, qualify, or affect in any manner whatsoever the personal recourse obligations and liabilities of the Indemnitors under this Indemnification Agreement.

10. This Indemnification Agreement may be executed in one or more counterparts by some or all of the parties hereto, each of which counterparts shall be an original and all of which together shall constitute a single Indemnification Agreement. The failure of any party listed below to execute this Indemnification Agreement, or any counterpart hereof, shall not relieve the other signatories from their obligations hereunder.

11. Except as set forth in paragraphs 10 and 11 of this Indemnification Agreement, the obligations and liabilities of the Indemnitors under this Indemnification Agreement shall terminate on the earlier to occur of (i) the date that the Debt has been repaid in full, or (ii) the date upon which the Property shall be transferred to Lender, its nominee or designee pursuant to the Transfer Documents held in escrow under the Escrow Agreement or pursuant to an uncontested judicial or non-judicial foreclosure action conducted in accordance with the Escrow Agreement.

IN WITNESS WHEREOF, the Indemnitors have duly executed this Indemnification Agreement the day and year first above set forth.

By: _________________________,

Name: _________________________,
Individually as Indemnitor

By: _________________________,

Name: _________________________,
Individually as Indemnitor

Accepted this _____ day of ______,19__

By: _________________________ ("Lender")

By: ___________________
Name: ___________________

ACKNOWLEDGEMENT

STATE OF ___________)
) SS.
COUNTY OF _________)

On this_____ day of _________________, 199__, before me appeared ____________________, to me personally known, who being by me duly sworn, did say that he executed the within Indemnity Agreement, and said ____________________ acknowledged said instrument to be his free act and deed.

Given under my hand and official seal, this _____ day of _______________, 199___.

____
Notary Public

My Commission Expires: ____________________

ACKNOWLEDGEMENT

STATE OF ___________)
) SS.
COUNTY OF _________)

On this _____ day of _________________, 199__, before me appeared ____________________, to me personally known, who being by me duly sworn, did say that he executed the within Indemnity Agreement, and said ____________________ acknowledged said instrument to be his free act and deed.

Given under my hand and official seal, this _____ day of _______________, 199___.

____
Notary Public

My Commission Expires: ____________________

EXHIBIT A

DEFINITIONS

Assignment of Leases and Rents: The term "Assignment of Leases and Rents" shall mean a certain Assignment of Landlord's Interest in Leases and Conditional Assignment of Rents dated as of _______________, 199__, given by Borrower to Lender, and recorded at Book ____, Page ____ of the Office of the Recorder of Deeds for _______________ County, _______________.

Borrower: The term "Borrower" as used herein shall mean _________________________, L.P., a ________________ limited partnership having its principal office at ___________________, _______________, ____________________.

Debt: The term "Debt" as used herein shall mean the obligations evidenced by the Loan Documents, as the same may be amended or modified in the future.

Deed: The term "Deed" as used herein shall mean a certain General Warranty Deed conveying the Property from Borrower to Lender, which Deed is to be held in escrow by First American Title Insurance Company pursuant to the terms and conditions of the Escrow Agreement.

Escrow Agreement: The term "Escrow Agreement" shall mean that certain Escrow Agreement dated as of __________, 199__ to be entered into by and among Borrower, Lender and First American Title Insurance Company, as escrow agent.

Modification and Extension Agreement: The term "Modification and Extension Agreement" shall mean that certain Modification and Extension Agreement to be entered into by and among Borrower, all of the partners of Borrower and Lender and to be recorded in the Office of the Recorder of Deeds for _______________ County, _______________.

Mortgage: The term "Mortgage" as used herein shall mean a certain Mortgage and Security Agreement dated as of __________, 19__ given by Borrower to Lender and recorded at Book _____, Page _____ of the Office of the Recorder of Deeds for _______________ County, _______________. The Mortgage grants Lender a first priority lien on the Property.

Note: The term "Note" as used in this Agreement shall mean a certain Note dated as of _______________, 199__ in the principal amount of ____________________ Dollars ($_______________) made by Borrower for the benefit of Lender

Pre-Workout Agreement: The term "Pre-Workout Agreement" shall mean that certain Pre-Workout Agreement dated as of _______________, 199__ entered into by and between Borrower and Lender.

Property: The term "Property" as used herein shall mean the real property (and the improvements located thereon) described at Exhibit B attached hereto and incorporated by reference herein.

UCC-1 Financing Statements: The term "UCC-1 Financing Statements" shall mean any and all UCC-1 Financing Statements or Fixture Filings filed by Lender against Borrower and all of Borrower's personal property, including any and all continuations, assignments or amendments filed with respect thereto.

EXHIBIT B

LEGAL DESCRIPTION OF PROPERTY

GUARANTIES AND FRAUDULENT TRANSFERS

By John C. Murray
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Introduction

A debtor may transfer assets before a bankruptcy filing, often to relatives or related entities, in order to protect these assets from being included in the debtor's estate and, therefore, subject to the claims of creditors. The purpose of § 548 of the Bankruptcy Code ("Code") is to avoid such fraudulent transfers. As one court has stated, "[t]the policy underlying § 548 [the fraudulent conveyance section of the Bankruptcy Code] is to protect creditors against the depletion of a bankruptcy estate through transfers of the debtor's interests in property taking place within one year before the bankruptcy petition was filed." *Max Sugarman Funeral Home, Inc. v. A.D.B. Investors*, 926 F.2d 1254, 1254 (1st Cir. 1991). Section 548 is derived from the Statute of 13 Elizabeth passed by the English Parliament in 1571. Statute 13 of Elizabeth "was aimed at a practice by which overburdened debtors placed their assets in friendly hands thereby frustrating creditors' attempts to satisfy their claims against the debtor." *Mellon Bank, N.A., v. Metro Communications, Inc.*, 945 F.2d 635, 644-45 (3rd Cir. 1991). Under § 548 of the Code, fraudulent conveyances may be set aside if they are made within one year prior to the filing of a petition in bankruptcy.

State Fraudulent Transfer Statutes

The fraudulent transfer provision of the Code, § 548(a)-(b), applies not only to transfers made by the debtor within one year before the commencement of the bankruptcy case, but also incorporates state fraudulent conveyance statutes. Both state law and the Code contain provisions that make transfers under certain circumstances void as to creditors of the transferor (the seller in the case of a sale transaction; the borrower in the case of a loan transaction). A transfer would violate these laws and may be voided by the trustee or debtor in possession if it is either intentionally fraudulent or constructively fraudulent as to the transferor's creditors.

Fraudulent conveyances may also occur under the Uniform Fraudulent Conveyance Act ("UFCA") or the Uniform Fraudulent Transfer Act ("UFTA") because § 544 of the Code gives the debtor or the trustee the status of a creditor as of the date of the petition. State fraudulent conveyance statutes do not require that the transfer be made within one year prior to the filing of the petition in bankruptcy because the action is independent of bankruptcy. However, if the trustee elects to proceed under state fraudulent conveyance laws, state statutes of limitation control. The UFTA, which has been adopted by 40 states, contains its

own statute of limitations. Under §§ 9(a) and 9(b), the UFTA extinguishes any claim not brought within four years after the transfer was made or the obligation was incurred. Under § 9(c), challenges to insider preferences must be brought within one year. Because the substantive claim terminates at the end of a specified time period, a bankruptcy trustee or an agent of the federal government, such as the IRS, may be barred from asserting remedies under the UFTA after the expiration of the specified time period even though general statutes of limitation are unenforceable against the federal government in some cases.

Definition of "Transfer"

Section 101(54) of the Code defines "transfer" as "every mode, direct or indirect, absolute or conditional, voluntary or involuntary, of disposing of or parting with property or with an interest in property, including retention of title as a security interest and foreclosure of the debtor's equity of redemption." The date of transfer, for fraudulent conveyance purposes, is the date on which the transfer would have become perfected against a subsequent bona fide purchaser under applicable state law.

A debtor may make a "transfer" by, among other things, incurring a debt or obligation or providing a guaranty, making a payment, granting a lien or security interest on its assets, or transferring all or a portion of its property. To constitute a fraudulent transfer under § 548(a)(1) of the Code, the transfer must be made with actual intent to hinder, delay, or defraud a creditor. Actual intent to defraud need not be shown by direct evidence, but may be inferred from the circumstances surrounding the conveyance, including reckless disregard of the consequences of the transaction and the subsequent conduct of the parties.

A transfer is also deemed to be constructively fraudulent under Section 548(a)(2) of the Code and may be set aside if, within one year prior to the filing of the bankruptcy petition, the creditor receives "less than reasonably equivalent value" in a transaction *and* the transaction does not meet any one of the following requirements: (1) the transferor was insolvent at the time of the transfer or was rendered insolvent as the result of the transfer, (2) the transferor was undercapitalized at the time of the transfer or became undercapitalized as the result of the transfer, or (3) the transferor was unable or rendered unable by the transfer to pay its debts as they became due. (These tests are sometimes referred to as the "insolvency test," the "capitalization test," and the "cash flow test"). Upon avoidance of the transfer, the property would then be transferred back to the estate, subject to a lien for whatever price was paid for the asset. Inadequate consideration would

not apply to sales at the market price that would generally benefit creditors and are not voidable.

Guaranties as Constructively Fraudulent Transfers

Constructively fraudulent transfers may be deemed to have occurred as the result of "upstream" or "sidestream" transfers (and. less often, "downstream" transfers), and other similar transactions, such as the following: leveraged buyouts; asset purchases where the seller's debts are assumed; mortgage loans to finance partner buyouts; transfers of all or a portion of the mortgage proceeds to a parent or sister entity without adequate consideration; guarantees of the mortgage indebtedness of a parent or sister entity (often securitized by a second mortgage on the property); cross-collateralization of existing mortgages with mortgage obligations owed by others; mortgages to secure debt proceeds distributed as dividends; transfers of assets to general partners; and the issuance of partnership or other equity interests in exchange for the contribution of real property(ies). Any of these transactions, depending on the facts, could result in a transfer for less than adequate consideration (i.e. "reasonably equivalent value") or cause the person or entity making the transfer to become insolvent.

With respect to intercorporate guaranties, courts have classified such transactions "into three categories: first, where a parent corporation or principal guarantees a subsidiary's obligation is termed a downstream guaranty; second, where a subsidiary guarantees the obligation of its sister corporation is termed a cross-stream guaranty; and third, where a subsidiary guarantees the parent's obligation is termed an upstream guaranty." ***Commerce Bank of Kansas City v. Achtenberg*****, 1993 U.S. Dist. LEXIS 16136 (W.D. Mo. Nov. 10, 1993) (Not reported in F.Supp.), at * 12 n.4 (citing** ***In re Metro Communications, Inc.*****, 95 B.R. 921, 923 (Bankr. W.D. Pa. 1989).**

An upstream loan transaction generally refers to any lending transaction where all or some portion of the loan proceeds are distributed directly to the owners of the borrowing entity. A sidestream loan transaction refers to the situation where all or some of the proceeds are distributed directly to an affiliated or "sister" entity. In either event, a fraudulent transfer may occur, under state law and/or under Section 548 of the Code,

because the mortgagor (who has not received the proceeds) remains obligated for the debt or has encumbered the mortgaged premises as security for the loan and may not have given reasonably equivalent value. Obligations that debtors incur solely for the benefit of third parties are presumptively not supported by a reasonably equivalent value. ***See, e.g., Rubin .v Manufacturers Hanover Trust Co.,*** **661 F.2d 979, 989 (2d Cir. 1981);** ***Marquis Products, Inc. v. Conquest Mills, Inc. (In re Marquis Products, Inc.)*****, 150 B.R. 487, 491 (Bankr. D. Me. 1993) ("It may be said that, as a general rule, an insolvent debtor receives 'less than a reasonable equivalent value' where it transfers its property in exchange for a consideration which passes to a third party. In such a case, it ordinarily receives little or no value,"** ***quoting Ear, Nose & Throat Surgeons of Worcester, Inc. v. Guaranty Bank & Trust Co.*****, 49 B.R. 316, 320 (Bankr. D. Mass. 1985)).**

The transaction may also render the mortgagor entity insolvent, under capitalized, or unable to meet its current debt obligations. On the other hand, "downstream" transfers, involving transfers by the debtor parent corporation to a (solvent) subsidiary, are generally presumed to be for reasonably equivalent value because the parent, which is usually the sole stockholder of the subsidiary, also receives any benefit that accrues to the subsidiary as the result of the transfer. There is thus deemed to be an "identity of interest" between the parties. With respect to a payment or guarantee by a debtor corporation of a loan to its wholly owned subsidiary, theoretically the reduction of the subsidiary's debt by virtue of payments thereunder increases, on a dollar-for-dollar basis, the value of the stock in the subsidiary owned by the parent. ***See Branch v. FDIC*****, 825 F.Supp. 384, 400 (D.Mass. 1993) (["t]his court is aware of no case in which transfers to a solvent subsidiary have been determined to be for less than equivalent value");** ***In re Metro Communications, Inc.*****, 95 B.R. 921, 933 (Bankr. W.D. Pa. 1989),** ***rev'd on other grounds*****, 945 F.2d 635 (3rd Cir. 1991);** ***Rubin v. Manufacturers Hanover Trust Co.*****, 661 F.2d 979, 991 (2nd Cir. 1981) (holding that § 548 of the Code does not authorize avoiding a transfer that "confers and economic benefit upon the debtor," either directly or indirectly).**

However, this presumption may be rebutted by evidence to the contrary. ***See, e.g. Commerce Bank of Kansas City, N.A. v. Achtenberg*****, No. 90-0950-CV-6, 1993 WL 476510 (Nov. 10, 1993) (Not reported in F.Supp) (finding, with respect to downstream guaranties of a corporate loan by two individuals who were the corporation's sole shareholders, that the debtor corporation was insolvent at the time of the guaranties and that such insolvency eliminated any indirect benefit to the shareholders-guarantors; the court noted, however, that if the debtor was only "marginally insolvent" at the time of the transfer, reasonably equivalent value might be found to exist). In** ***General Electric Credit Corp. v. of Tennessee v. Murphy (In re Rodriguez)*****, 895 F.2d 725 (11th Cir. 1990), the court held that the debtor corporation did not receive reasonably equivalent value where its individual shareholder guaranteed the debt of the debtor corporation's wholly owned subsidiary but the debtor corporation acted as if it were the guarantor and actually made the loan payments to the lender after the loan was in place. The court found that the payments by the debtor corporation did not create any equity in the subsidiary's sole asset, a jet aircraft, which had been sold by the lender for less than half of the remaining loan amount and that the debtor corporation did not benefit directly or indirectly from reducing a debt it was not liable for. The court suggested that reasonably equivalent value might have been demonstrated had the debtor corporation itself entered into a guaranty with the lender at the time of the original loan because use of the loan proceeds by the subsidiary would have been of benefit to the debtor corporation.**

Reasonably Equivalent Value

When analyzing whether reasonably equivalent value exists in connection with a "cross-stream" or "side-stream" guarantee by a corporation of a sister entity's debt, the courts often focus on whether such guaranties are customary and reasonably expected by creditors, and whether such obligations enhance the financial strength of the entire corporate "group" either directly or indirectly and therefore provide value to all of the members. If, instead, the result of such guaranties is that the creditors of a high-performing solvent entity are put at increased (and unreasonable) risk for the sake of an affiliated entity that is insolvent or on the brink of insolvency, then courts are more likely to find that the

transfer was made for less than reasonably equivalent value and therefore fraudulent. Often, the subsidiaries are of varying financial strength, and creditors of a stronger subsidiary may be put at increased and unreasonable risk as a result of the cross-guaranty. The courts will analyze closely whether the cross-guaranty obligation results in a true benefit to the debtor, such as increased synergy with the group or increased credit availability, and whether the corporate group as a whole was a viable business enterprise at the time of the guaranty. *See Mellon Bank, N.A., v. Metro Communications, Inc.*, 945 F.2d 635, 647 (3rd Cir. 1991), *cert. denied,* 112 S.Ct. 1476 (1992); *Telefast, Inc. v. VU-TV, Inc.*, 591 F.Supp. 1368 (D. N.J. 1984); Barry L. Zaretsky, *Fraudulent Transfer Law as the Arbiter of Unreasonable Risk*, 46 S.C. L. Rev. 1165, 1193-96 (1995); Robert J. Rosenberg, *Intercorporate Guaranties and the Law of Fraudulent Conveyances*: *Lender Beware*, 125 U. Pa. L. Rev. 235 (1976); Jack F. Williams, *The Fallacies of Contemporary Fraudulent Transfer Models as Applied to Intercorporate Guaranties: Fraudulent Transfer Law as a Fuzzy System*, 15 Cardozo L. Rev. 1403 (1991).

The existence of an upstream transfer, where the consideration has passed to a third party, does not conclusively establish that the transferor did not receive reasonably equivalent value. A subsidiary that guarantees a parent's debt could, for example, receive indirect benefits such as securing a future sale, obtaining a line of credit otherwise unavailable, or even improving its public image or "goodwill" through consummating a large transaction. *See, e.g., Telefast, Inc. v. VU-TV*, 591 F.Supp. 1368, 1379 (D.N.J. 1984); *Marquis Products, Inc. v. Conquest Carpet Mills, Inc. (In re Marquis Products, Inc.)*, 150 B.R. 487, 491 (1993) ("a subsidiary receives an indirect benefit where its upstream guarantee enables its parent to procure a loan and, thus, to provide funds to the subsidiary"); *Mellon Bank, N.A. v. Metro Communications, Inc.*, 945 F.2d 635, 647 (3rd Cir. 1991) ("it is appropriate to take into account intangible assets not carried on the debtor's balance sheet, including, inter alia, good will").

Upstream, downstream, and cross-stream transactions can also be effected through cross-collateralization, even in the absence of a formal guaranty. To pledge one's assets as security for the obligation of another is to become a guarantor regardless of whether any document

evidencing the guaranty obligation is executed. Cross-collateralization is a very common structuring technique in securitized loan transactions today. Typically, as required by the lender, a "bankruptcy remote" or "special purpose" entity ("SPE") is created, to which certain assets of a parent entity will be conveyed that are intended to act as security for a loan.

The purpose this "bankruptcy remote" structure is to make it difficult for the SPE borrower to file bankruptcy. However, bankruptcy "remote" does not mean bankruptcy "proof." In many commercial transactions, it is not uncommon to create as many bankruptcy-remote entities as there are real property assets or, in multi-state transactions, to form as many bankruptcy- remote borrowing entities as there are states. Each newly created entity typically will be an SPE that is wholly owned by the parent entity (although not always on a direct basis; the entity formed to hold title to the real property asset may be owned by another entity or entities, often itself or themselves a bankruptcy-remote SPE or SPEs, which entity or entities may in turn be wholly owned by the ultimate parent).

The ultimate purpose of the loan may simply be to refinance existing secured debt. If the loan were made to the parent, which pledged its own assets as security for the loan, and the proceeds were used to pay off the parent's existing secured debt, there would likely be no creditors' rights issue and the title insurer could be expected to insure the transaction without a creditors' rights exclusion or exception. However, because the lender (or the rating agency that will be rating the transaction if it is to be securitized) desires to isolate the assets that will be the security from the parent's general business operations (and other creditors), a bankruptcy-remote SPE will be the preferred form of borrowing entity.

There are at least two transfers in these transactions that must be analyzed for creditors' rights issues by title insurers. The first is the transfer of title from the parent to the newly created entity or entities of the assets that will be the security for the loan. The second is the mortgaging of those assets by the newly formed entity or entities. The actual borrower may be the parent (in which event the transaction becomes in effect becomes an upstream guaranty), but it is usually the bankruptcy-remote SPE itself. A separate loan might be made to each SPE, secured by the asset or assets of that particular SPE received from the parent. If the structure stopped there, and assuming that the loan being refinanced became the obligation of the SPE at the time title to the asset or assets was conveyed by the parent to the SPE (and also assuming that the parent received "reasonably equivalent value" for its transfer to the SPE), the loan transaction involving the existing secured debt might not involve a creditors' rights issue (except possibly an intentional fraudulent transfer). However, rarely is this type of loan transaction structured as a series of truly "stand alone" loans to each separate SPE. Instead, each SPE pledges its asset or assets as security for its own promissory note *and* for the promissory notes executed by each of the other "sister" SPEs. There may in fact be a formal guaranty by each SPE of the indebtedness of each of these other SPEs (which in turn may be secured by a subordinate

mortgage on each of the other properties mortgaged by the respective SPEs). This results in cross-collateralization, as each asset stands as collateral for the "global" loan (being the sum of all of the separate loans made to each SPE), although each individual SPE has only benefited from a portion of the loan proceeds.

The common theme in upstream, downstream and cross-stream transactions is that someone other than the entity whose assets stand as security for the loan is benefiting from the loan proceeds and - at least to the extent of the benefit flowing to the parent, subsidiary or sister entities - the "transferring" entity is not receiving reasonably equivalent value. Therefore, a fraudulent transfer challenge can be made by the creditors (or bankruptcy trustee) of the parent, who could attack the transfer to the SPE as one (1) made to "hinder, delay or defraud" the parent's existing or future creditors, or (2) that rendered the parent insolvent, or (3) that left the parent with insufficient capital to carry on its business, or (4) that occurred when the parent was unable to pay its debts as they became due. The SPE's creditors (or bankruptcy trustee) could also challenge the transaction as a fraudulent transfer, based on some or all of the same theories. The transfer of assets by a parent to a subsidiary also could constitute a preference if the parent had guaranteed the subsidiary's indebtedness, and is subsequently released from the guaranty obligation when the subsidiary uses the proceeds to of the new secured loan to satisfy an existing obligation of the subsidiary that the parent had guaranteed.

Leveraged Buyout Transactions

Concerns about upstream transfers and guaranties were highlighted in the 1980s, when courts began to apply fraudulent conveyance law (both state and federal) to leveraged buyout transactions. A leveraged buyout refers to the acquisition of a "target" corporation in which all or a substantial portion of the purchase price paid for the stock of the target corporation is borrowed from a third party and where the loan financing the transaction is secured by the assets of the target corporation. Usually the buying entity infuses little or none of its own funds as equity, and therefore the transaction results in equity being exchanged for debt.

Upstream transactions are characterized, in the case of leveraged buyout transactions, by subsidiary guaranties of the debt obligations of the guarantor's new parent corporation to the lender that financed the acquisition of the stock of the subsidiary-guarantor. In a leveraged buyout transaction, the transferor generally receives less than reasonably equivalent value because it conveys the property in exchange for consideration that passes to a third party. As one court has stated, "The target corporation . . . receives no direct benefit to offset the greater risk of now operating as a highly leveraged corporation." *Mellon Bank v. Metro Communications, Inc. (In re Metro Communications, Inc.)*, 945 F.2d 635, 646 (3rd Cir. 1991); *cert. denied sub nom. Committee of Unsecured Creditors v. Mellon Bank, N.A.*, 503 U.S. 937, 112 S.Ct. 1476 (1992). The court in *Mellon Bank* noted that:

> The effect of an LBO is that secured creditors replace a corporation's shareholders. Put simply, stockholders' equity is supplanted by debt. The level of risk facing the newly structured corporation rises significantly due to the increased debt to equity ratio. This added risk is borne primarily by the unsecured creditors, those who will most likely not be paid in the event of insolvency.
>
> 945 F.2d at 646.

Where it is alleged that the lender knew that the borrowing entity would not receive the loan proceeds but would nevertheless assume responsibility for repaying the debt, and it is further alleged that the eventual insolvency and bankruptcy of the borrower were foreseeable results of the leveraged buyout, the trustee in bankruptcy has adequately pleaded a cause of action for fraudulent conveyance and may seek to "collapse" the various loans, stock purchases and repayment obligations into one transaction. *See, e.g., CPY Co. v. Ameriscribe Corp. (In re Chas. P. Young Co.)*, 145 B.R. 131, 137 (Bankr. S.D.N.Y. 1992) ("[r]egardless of the number of steps taken to complete a transfer of debtor's property, such as in a leveraged buyout transaction, if they reasonably collapse into a single integrated plan and either defraud creditors or leave the debtor with less than equivalent value post-exchange, the transaction will not be exempt from the Code's avoidance sections").

The lender may be required to make a reasonable determination that the leveraged buyout is consistent with the rights of the borrower's (i.e., the target company's) unsecured creditors before disbursing the loan funds, because it is essential to view such transactions from the perspective of such creditors. Also, when a target company assumes liabilities or transfers security interests in its property and the consideration (or loan proceeds) is immediately passed to the target company's shareholders or third parties, lack of fair or reasonable consideration is usually presumed. *See United States v. Gleneagles Inv. Co.*, 565 F.Supp. 556 (M.D. Pa. 1983)*, aff'd in part and vacated in part sub nom United States v. Tabor Court Realty Corp.*, 803 F.2d 1288 (3d Cir.1986), *cert. denied sub nom. McClellan Realty Corp. v. United States*, 483 U.S. 1005, 107 S.Ct. 3229 (1987). *See also Ferrari v. Barclays Business Credit (In re Morse Tool, Inc.)*, 108 B.R. 389, 391 (Bankr. D. Mass. 1989); *Wieboldt Stores v. Schottenstein*, 94 B.R. 488, 499 (N.D. Ill. 1988); *MFS/Sun Life High Yield Series v. Van Dusen Airport Services Co.*, 910 F.Supp. 913 (S.D.N.Y. 1995); *In re Ohio Corrugating Co.*, 91 B.R. 430, 435 (Bankr. N.D. Ohio 1988)*, In re Revco, Inc.*, 118 B.R. 468, 518 (Bankr. N.D. Ohio 199); *Aluminum Mills Corp. v. Citicorp North America, Inc.*, 132 B.R. 869, 886-87 (N.D. Ill. 1991); *In re Resorts Int'l, Inc.*, 145 B.R. 412, 457-58 (Bankr. D. N.J. 1990) ("[c]ourts have not hesitated to apply state fraudulent conveyance law to leveraged buyouts, particularly in cases where there is evidence of intent to defraud and knowledge of the LBO"); *Crowthers McCall Pattern, Inc. v. Lewis*, 129 B.R. 992, 998 (S.D.N.Y. 1991) ("under the fraudulent conveyance laws, a lender is required to make a reasonable determination that the buy out is consistent with the rights of creditors before advancing funds"); *Orr v. Kinderhill Corp.,* 991 F2d 31, 36 ((2nd Cir. 1993) (finding a fraudulent conveyance under state law, where the lender knew

that the net effect of its mortgage loan was a transfer of the property without any benefit to the debtor-transferor); Baird & Jackson, *Fraudulent Conveyance Law & Its Proper Domain*, 38 Va. L.Rev. 829 (1985); Murdoch, Sartin & Zadek, *Leveraged Buyouts & Fraudulent Transfers: Life After Gleneagles,* 43 Bus. Law. 1 (1987); Kirby, McGuinness & Kendell, *Fraudulent Conveyance Concerns in Leveraged Buyout Lending,* 43 Bus. Law. 27 (1987).

But see Mellon Bank v. Metro Communications, Inc. (In re Metro Communications, Inc.), 95 B.R. 921, 932-33 (Bankr. W.D. Pa. 1989), *rev'd on other grounds),* 945 F.2d 635 (3rd Cir. 1991); *cert. denied sub nom. Committee of Unsecured Creditors v. Mellon Bank, N.A.*, 503 U.S. 937, 112 S.Ct. 1476 (1992) (ruling that, although the bankruptcy statute prohibiting fraudulent transfers applies to leveraged buyouts, there is no *per se* rule that a leveraged buyout loan collateralized with the target's own assets renders the target debtor insolvent and, therefore, automatically vulnerable to a fraudulent transfer attack); *Wieboldt Stores, Inc. v. Schottenstein, supra*, 94 B.R. at 500 ("Although . . . fraudulent conveyance laws generally are applicable to [leveraged buyout] transactions, a debtor cannot use these laws to avoid any and all [such transactions]"); *Ohio Corrugating Co. v. DPAC, Inc.*, 91 B.R. 430, 439-40 (Bankr. N.D. Ohio 1988) (holding that the transaction was not a fraudulent conveyance because the plaintiffs had failed to prove that the defendant was insolvent at the time of the leveraged buyout): *Kupetz v. Wolf*, 845 F.2d 842, 847-49 (9th Cir. 1988) (refusing to find a fraudulent conveyance as the result of the sale of a debtor corporation in a leveraged buyout where there was no actual intent to defraud and the shareholders had no knowledge of the LBO structure used to purchase their shares; the court declined to analyze a leveraged buyout under the constructive fraud provisions of the California UFCA on the theory that it would be "inappropriate to utilize constructive intent to brand most, if not all, LBOs as illegitimate").

Strategies to Minimize Risk

Since the early 1980s, borrowers (and title companies) have struggled to come up with a method of minimizing the risks of fraudulent conveyances in mortgage loan transactions (especially in connection with multi-property and multi-state transactions), while still providing lenders the protections that they are seeking when utilizing devices such as upstream and sidestream guaranties.

Proposed solutions, which have been used with varying degrees of acceptance and success, include the following:

(5) a "net worth guaranty" (a sample form of which is attached hereto as **Exhibit "A")**, under which the guarantor guarantees all or a portion of another party's indebtedness or the aggregate indebtedness of numerous parties, but in an amount not greater than, e.g., 95 percent of its net worth on an ongoing basis in order avoid rendering the guarantor insolvent;

(6) statements or provisions in the guaranty agreements, and any mortgages securing such guaranty obligations, to the effect that it is the parties' intention that the obligations of each guarantor shall not constitute a fraudulent transfer or conveyance under the Code or any applicable state law (sample forms of such provisions are attached hereto as **Exhibits "B" and "C"**);

(7) a separate affidavit and certificate as to the organizational and financial status of the guarantor(s) and the debts and liabilities of the guarantor(s) (a sample form of which is attached hereto as **Exhibit "D"**);

(8) a "contribution agreement" among all the borrowers-guarantors providing that in the event that any individual borrower-guarantor guaranteeing the indebtedness of other borrowers-guarantors is required to, and actually does, make a payment on such guaranty for the benefit of another borrower-guarantor, it will thereupon have a right of indemnification against the defaulting borrower-guarantor for the amount (which may be an allocated portion of the aggregate debt) paid by the non-defaulting borrower-guarantor (a sample form of which is attached hereto as **Exhibit "E"**); and

(5) an indemnification agreement from the common principal or parent of each borrowing entity (which entities are commonly bankruptcy-remote "pass through" SPEs) to the title insurance company (which indemnity may or may not be secured by additional collateral such as a cash deposit, certificate of deposit, or letter of credit), indemnifying the title company for any claims successfully asserted against it as the result of the failure of the lender to realize on its security because a fraudulent transfer has been deemed to have occurred as a result of the transaction.

Notwithstanding their increasing use and the benefits provided by such documents, net worth guaranties may have the following disadvantages:

(5) the transaction may still be deemed a fraudulent transfer because it fails one of the tests, other than insolvency, under Section 548 of the Code, i.e., the guaranty causes the guarantor to fail either the capitalization test or the cash flow test;

(6) the difficulty of determining and verifying the actual net worth of the guarantor (or multiple guarantors) at any given point in time;

(7) the potential inability to collect the full amount of the guaranty because of the guaranty agreement's limitation to a specified amount of the guarantor's net worth and the possible miscalculation or misrepresentation of such net worth; and

(8) the lack of reported court decisions determining the validity and enforceability of net value guaranties.

Based on the case law over the past several years, lenders may in fact be safer (or just as safe) taking a full, unrestricted guaranty from each of the guarantors. For example, in *In re Xonics Photochemical, Inc.*, 841 F.2d 198, 200 (7th Cir. 1988), the court held that the amount of a subsidiary's liability on an upstream limited guaranty must be discounted by the probability that the contingency (payment on the guaranty) will actually occur. As a result of this ruling, the possibility that a court will find that a guarantor's payment obligations on an aggregate indebtedness will render the guarantor insolvent has been lessened, because the contingent obligation must be discounted. In addition, a "full value" guaranty, when used in the proper circumstances, may eliminate or reduce the risks of litigation, collection and uncertainty of enforceability that are inherent in net worth guaranties. Also, the contingent nature of a particular guarantor's liability may have to be further adjusted based on the guarantor's rights (commonly contained in commercial loan guaranties) of subrogation, indemnification, and reimbursement against the defaulting guarantor(s) or the primary obligor.

See also Official Comm. of Former Partners of Brennan (In re Labrum & Doak), 227 B.R. 383, 389 (Bankr. E.D. Pa. 1998) (suggesting a per se rule that future rent obligations are contingent liabilities and are to be excluded for insolvency valuation purposes); *Covey v. Commercial Nat'l Bank of Peoria*, 960 F.2d 657, 660-62 (7th Cir. 1992); ("[d]iscounting a contingent liability by the probability of its occurrence is good economics and therefore good law"); *Davis v. Suderov (In re Davis),* 169 B.R. 285, 302-03 (E.D. N.Y. 1994) ("In order to value a contingent liability, a bankruptcy court must determine the likelihood that the contingency will occur, and multiply the total debt guaranteed by that probability"); *Mellon Bank, N.A., v. Metro Communications, Inc.*, 945 F.2d 635, 648 (3rd Cir. 1991) (requiring that the value of the guaranty be reduced to the extent that the guarantor was entitled to contribution from co-guarantors at the time of the loan); *In re Chase & Sanborn Corp.*, 904 F.2d 588, 594 (11th Cir. 1990), ("a contingent liability cannot be valued at its potential face amount; rather, 'it is necessary to discount it by the probability that the contingency will occur and the probability will become real'" (quoting *In re Xonics Petrochemical, Inc.*, 841 F.2d198, 200 (7th Cir. 1988)); *In re Hemphill*, 18 B.R. 38, 47 (S.D. Iowa 1982) ("If the guarantee obligation is to be included among the debtor's liabilities for purposes of determining his insolvency, then the subrogation and contribution rights against other collateral must also be taken into account"); Brad R. Godshall and Robert A. Klyman, *"Wading 'Upstream' in Leveraged Transactions: Traditional Guarantees v. 'Net Worth' Guarantees,"* 46 Bus. Law. 391 (1991). *cf.*

Commerce Bank of Kansas City, N.A., v. Achtenberg, No. 90-0950-CV-W-6, 1993 WL 476510 (W.D. Mo. Nov. 10, 1993) (Not reported in F.Supp), at *5 n.6 (finding that because the evidence had established that the debtors guaranteed a loan to an insolvent entity, the contingency no longer existed and the guaranty was fully payable);

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Conclusion

Most commercial real-estate mortgage lenders consider creditors' rights issues to be of paramount importance when negotiating the documentation for loan transactions. As highlighted in this paper, these issues often arise in connection with guarantees of a borrower-related individual or entity's obligations. Unfortunately, there is no simple solution that applies to every fact situation. The mortgage lender (and its counsel) should carefully analyze and evaluate the risks involved in a particular transaction. The lender must balance its desire to protect its rights in the real property collateral (and its remedies with respect to repayment of the mortgage indebtedness, including enforcement of guaranties) with the need to minimize the risk of potential challenges based on the violation of federal and state bankruptcy and insolvency statutes. By working closely with each other and sharing relevant information at each stage of the transaction, lenders and title insurers can often effect creative solutions to creditors' rights issues involving loan guaranties.

EXHIBIT "A"

CROSS GUARANTY AGREEMENT

This **CROSS GUARANTY AGREEMENT**, (this "Agreement") dated as of the ___ day of _________, ____ is made by ___________________________, a ____________ corporation, having an office at _____________ ("__________") and those wholly owned subsidiaries of __________ listed on the signature lines below (the "Affiliated Guarantors"; ____________ and the Affiliated Guarantors being hereinafter referred to, collectively, as the "Guarantors", with each such entity being hereinafter referred to individually as a "Guarantor"), to and for the benefit of ________________________________ a ___________ corporation, having an office at __________________________ ("Lender").

W I T N E S S E T H:

WHEREAS, Lender has made a number of loans (collectively, "Loans"), each evidenced by a separate promissory note (individually, a "Note") to certain Affiliated Guarantors, as such Loans and Affiliated Guarantors are described more particularly on **Schedule 1** attached hereto and made a part hereof; and

WHEREAS, each Note is secured by a first-lien mortgage or deed of trust on the various properties identified on **Schedule 1**, as said secured real and personal property is more particularly described in the respective mortgages or deeds of trust (each such property being hereinafter referred to as a "Property" and all of such Property being hereinafter collectively referred to as the "Total Property"); and

WHEREAS, the aggregate amount now or hereinafter outstanding under the Loans (such total amount being hereinafter referred to as the "Aggregate Debt" and being further defined below is currently secured by the Total Property, under a cross-collateralization program previously approved and entered into by Guarantors and Lender; and

WHEREAS, the parties hereto desire to clarify their respective rights and obligations as to the Aggregate Debt and as to the Total Property, and to revise the circumstances under which one or more Property may be released from the pool of Total Property securing the Aggregate Debt; and

WHEREAS, the obligations of Guarantors under this Agreement shall be secured by, amount other things, those various second deeds of trust or second mortgages of even date herewith entered into by each of the Affiliate Guarantors and to be recorded as a second lien on the respective Property owned by that Affiliated Guarantor (such deeds of trust and mortgages, together with all amendments, supplements and renewals thereof, being hereinafter collectively referred to as the "Second Mortgages"); and

WHEREAS, as a condition to extending additional credit to current and future affiliates of **______________**, Lender has required that this Agreement be entered into.

NOW, THEREFORE, in consideration of Ten Dollars ($10.00), and other good and valuable consideration, the receipt and legal sufficiency of which are hereby acknowledged, Guarantors do hereby covenant and agree with Lender as follows:

1. **Guaranty**.

(a) Guarantors hereby absolutely, unconditionally and irrevocably guarantee to Lender, on a joint and several basis, the following (collectively, the "Guaranteed Obligations"): (i) the full and punctual payment when due, and not merely the collectability, whether by lapse of time, by acceleration of maturity, or otherwise, and at all times thereafter, of all principal, interest (including interest accruing after the commencement of any bankruptcy or insolvency proceeding by or against any Guarantor, whether or not allowed in such proceeding), commitment fees, extension fees, deferred financing fees, other fees, late charges, costs, expenses, indemnification indebtedness, and other sums of money now or hereafter due and owing under all of the Loans, and all renewals, extensions, refinancings, modifications, supplements or amendments of such indebtedness (collectively, the "Aggregate Debt"), and (ii) the full and timely performance and observance of all representations, obligations, covenants and agreements contained herein, in the Second Mortgages and in any loan documents now or previously executed by any Guarantor in connection with any of the Loans (collectively, the "Total Loan Documents"). This guaranty of Guarantors as set forth in this Section is a continuing guaranty of payment and not a guaranty of collection.

(b) The obligations of Guarantors under this Agreement shall be absolute, unconditional and irrevocable regardless of the genuineness, validity, regularity or enforceability of any or all of the Total Loan Documents, and shall remain in full force and effect and shall not be released, discharged, affected, modified or impaired by reason of the happening from time to time of any event, including without limitation, any one or more of the following:

(i) the compromise, settlement or termination of any or all of the representations, obligations, covenants or agreements of any Guarantor under any of the Total Loan Documents, or the compromise, settlement, or termination of any or all of the obligations of any Guarantor by operation of law or otherwise; or

(ii) the delay or failure to give notice to any Guarantor of the occurrence of an event of default under the terms and provisions of this Agreement or the Total Loan Documents; or

(iii) the waiver by Lender of the payment, performance or observance by any Guarantor of any of the representations, obligations, covenants or agreements contained in this Agreement or any of the Total Loan Documents; or

(iv) the extension of time for payment of all or any portion of the Aggregate Debt or of the time for performance of any other obligations, covenants or agreements under or arising out of this Guaranty or the Total Loan Documents, or the extension or renewal of any thereof; or

(v) the transfer, disposition, sale or pledge of the right of Lender under, or any surrender, compromise, settlement, release, renewal, extension, indulgence, alteration, substitution, exchange, change in, supplement, modification or amendment (whether material or otherwise) of any obligation, covenant or agreement under this Agreement or under any Total Loan Document; or

(vi) the taking of omission of any of the actions authorized or permitted under this Agreement or any Total Loan Document; or

(vii) any invalidity or unenforceability of any terms or provisions of this Agreement or any Total Loan Document, or any loss or release or substitution of , or other dealing with, any security which is created by this Agreement or the Total Loan Documents; or

(viii) any failure, omission or delay on the part of Lender to enforce, assert or exercise any right, power or remedy conferred on Lender in this Agreement or any other act or acts on the part of Lender or any successor or assign of the Total Loan Documents; or

(ix) the voluntary or involuntary liquidation, dissolution, sale or other disposition of all or substantially all of the assets and liabilities, receivership, insolvency, bankruptcy assignments for the benefit of creditors, reorganization, arrangement, composition with creditors or readjustment of, or other similar proceeding affecting or any of the other Guarantors, or any of the assets of any of them, or any allegation of invalidity or contest of the validity of this Agreement in any such proceedings; or

(x) the default or failure of any Guarantor fully to perform any of its obligations set forth in this Agreement; or

(xi) the failure to perfect or delay in perfecting or continuing the perfection of any security interest in any property which secures the obligations of any Guarantor under this Agreement or the Total Loan Documents, or to protect the property covered by such security interests; or

(xii) the failure to give notice of any disposition of any collateral covered by any security interest or to dispose of such collateral in a commercially reasonable manner; or

(xiii) The taking or omission of any action authorized or permitted by Lender in connection with any other guaranty agreement, environmental indemnity agreement or other indemnity or guaranty undertaking entered into by any of the Guarantors, including without limitation, those guaranty agreements entered into by _____________ and each of the Affiliated Guarantors at the time of the closing of a Loan to that particular Affiliated Guarantor.

(c) No set-off, counterclaim, reduction or diminution of any obligation, or any defense of any kind or nature which any Guarantor may have against Lender shall limit or in any way affect the joint and several obligations of Guarantors under subsection 1(a) above.

2. Liability Cap**.**

The total aggregate liability of each Guarantor hereunder shall be limited to the sum set forth opposite that Guarantor's name on Schedule 1 **hereto in the column entitled "Guaranty Ceiling", exclusive of amounts due but not paid hereunder (which shall accrue interest from and after the date when due at the default rate of interest set forth in the Note) and exclusive of all costs of enforcement of this Agreement, including but not limited to, Lender's attorney's fees and costs.**

3. Second Mortgage**.**

This Agreement is secured by each of the Second Mortgages. The obligations, covenants and agreements of the Second Mortgages are hereby made a part of this Agreement to the same extent and with the same effect as if they were fully set forth herein, and each Guarantor does hereby agree to perform and keep each and every obligation, covenant and agreement set forth in this Agreement and each Second Mortgage.

4. Waivers and Acknowledgments**.**

(a) Each Guarantor hereby waives: (i) notice of acceptance of this Agreement by Lender and of presentment, demand, protest, notice of protest and of dishonor, notice of default and all other notices of every kind or nature now or hereafter provided by agreement or available at law, including, without limitation, notice of default, notice of intention to accelerate all sums under the Total Loan Documents, and notice of acceleration of all sums under the Total Loan Documents; (ii) any right to require or compel Lender, prior to exercising its right hereunder to first proceed against any other Guarantor or any security for any of the Loans, or to pursue any other

remedy available to Lender. Lender's failure to exercise, or delay in exercising, any right or power hereunder shall not operate as a waiver thereof, nor shall any single or partial exercise by Lender of any right, remedy or power hereunder preclude any other or future exercise of any other right, remedy or power. Each Guarantor acknowledges that Lender may seek recovery for any Guaranteed Obligations and may exercise any remedies it may have against any or all of the Guarantors with respect to such Guaranteed Obligations with the same force and effect as if each Guarantor were a primary obligor under the Total Loan Documents.

(b) Each Guarantor further agrees that the validity of this Agreement and the obligations of each Guarantor hereunder shall in no way be terminated, affected or impaired by reason of: (i) the assertion by Lender of any rights or remedies which it may have under or with respect to the Total Loan Documents, against any person obligated thereunder or against the owner of the property secured thereby; (ii) any failure to file or record any of the Total Loan Documents or to take or perfect any security intended to be provided thereby; (iii) the release or exchange of any property or any other collateral for the Loan; (iv) the commencement of a case under the Bankruptcy Code, 11 U.S.C. §101 et seq., as amended from time to time (the "<u>Bankruptcy Code</u>"), by or against _________________ or any person obligated under the Total Loan Documents; or (v) any payment made on the Aggregate Debt, whether made by any Guarantor or any other person, it being understood that no payment so refunded shall be considered as a payment of any portion of the Aggregate Debt, nor shall it have the effect of reducing the liability of any Guarantor hereunder. It is further understood that if any Guarantor shall have taken advantage of, or be subject to the protection of, any provision of the Bankruptcy Code, the effect of which is to prevent or delay Lender from taking any remedial action against such Guarantor, including the exercise of any option Lender has to declare all or any portion of the Aggregate Debt due and payable on the happening of any default or event by which, under the terms of the Total Loan Documents, all or any portion of the Aggregate Debt shall become due and payable, Lender may, as against any Guarantor, nevertheless, declare the Guaranteed Obligations due and payable and enforce any and all of its rights and remedies provided for herein.

(c) Each Guarantor further covenants: (i) that this Agreement shall remain and continue in full force and effect as to any modification, extension or renewal of any of the Loans, (ii) that Lender shall not be under a duty to protect, secure or insure any security or lien provided by the Total Loan Documents or other collateral for any of the Loans; and (iii) that other indulgence or forbearance may be granted under any or all of the Total Loan Documents, without notice to or further consent of any Guarantor.

(d) Each Guarantor acknowledges that if any demand is made at any time upon Lender for repayment or recovery of any amount or amounts received by it in payment of or on account of the Guaranteed Obligations, and if Lender shall repay all or any part of said amounts by reason of any judgment, decree or order of any court or administrative body or by reason of any settlement or compromise of such demand, each Guarantor shall be and remain liable hereunder for the payment of such amount or amounts so repaid by Lender to the same extent as if such amount or amounts had never been received originally by Lender. By way of example, and in no way limiting the foregoing, the payment of an item deemed to be a preference by Lender to a bankruptcy court or other entity is covered by the preceding sentence.

5. No Fraudulent Conveyance**.**

Notwithstanding any contrary provision contained in this Agreement, Guarantors, and by its acceptance hereof, Lender, hereby confirm that it is their intention that the obligations of each Guarantor hereunder shall not constitute a fraudulent transfer or obligation for the purposes of the Bankruptcy Code and applicable state law, including any state law based on the Uniform Fraudulent Transfer Act or the Uniform Fraudulent Conveyance Act. To effectuate the foregoing intention, Lender irrevocably agrees that the aggregate liability of each Guarantor under this Agreement shall in no event exceed, at any time, ninety-five percent (95.0%) of the "Net Asset Value" (as hereafter defined). As used herein, the term "Net Asset Value" means (x) the fair saleable value of the assets, on a going

concern basis, of each Guarantor as determined from time to time, minus (y) the total fair value of the bona fide liabilities of such Guarantor (including contingent liabilities, but excluding liabilities of such Guarantor under this Agreement) as determined from time to time but on the same date the value of the assets is determined pursuant to (x) above. In no event will payments made by each Guarantor be returned by virtue of a subsequent decrease in the Net Asset Value.

6. Event of Default**. The following shall constitute a default under this Agreement, and the terms "Default", default, "event of default" and "Event of Default" shall mean, whenever they are used in this Agreement, any one or more of the following events:**

(a) The occurrence of a default after he expiration of any applicable notice and cure periods, or any Default, event of default or Event of Default under any of the Total Loan Documents;

(b) Failure by any Guarantor to observe and perform any covenant, condition or agreement on its part to be observed or performed hereunder within the appropriate time period;

(c) Any Guarantor shall (i) apply for or consent to the appointment of or the taking of possession by a receiver, custodian, trustee, liquidator or the like of any of the Guarantor's property, (ii) admit in writing its inability, or failure, to pay its debts generally as such debts become due, (iii) make a general assignment for the benefit of its creditors, (iv) commence a voluntary case under any chapter of Title 11 of the United States Code (as now or hereafter in effect, the "Bankruptcy Code"), (v) file a petition seeking to take advantage of any other law relating to bankruptcy, insolvency, reorganization, winding-up, or composition and adjustment of debts, (vi) acquiesce in writing to any petition filed against it in an involuntary case under the Bankruptcy Code or

under any law referred to in clause (v) above, or (vii) take any action for the purpose of effecting any of the foregoing;

(d) A proceeding or case shall be commenced, without the application or consent of any Guarantor in any court of competent jurisdiction, seeking (i) the liquidation, reorganization, dissolution, winding-up or composition and adjustment of debts of such Guarantor, (ii) the appointment of a trustee, receiver, custodian, liquidator or the like of such Guarantor or of all or any of its respective assets, or (iii) similar relief in respect of such Guarantor under any law relating to bankruptcy, insolvency, reorganization, winding-up or composition and adjustment of debts, and such proceeding or case shall continue undismissed, or an order, judgment or decree approving or ordering any of the foregoing shall be entered and continue unstayed and in effect, for a period of 30 days, or any order for relief against such Guarantor shall be entered in an involuntary case under such Bankruptcy Code;

(e) Any representation or warranty made by any Guarantor herein or in any document or certificate furnished to Lender in connection herewith shall be incorrect when made in any material respect; or

(f) Any provision of this Agreement shall at any time for any reason cease to be valid and binding in accordance with its respective terms on each Guarantor, or shall be declared to be null and void or the validity or enforceability thereof shall be contested by any Guarantor or proceedings shall be commenced by any Guarantor seeking to establish the invalidity or unenforceability thereof or any Guarantor shall deny that it has any or further liability or obligation under this Agreement.

Each Guarantor shall give Lender prompt written notice of the occurrence of any Event of Default of which such Guarantor has actual or constructive notice.

7. Remedies on Default**. Whenever any default of this Agreement shall have occurred, Lender may take any remedial action permitted by law or in equity or under this Agreement, any of the Total Loan Documents, or the Second Mortgages, including declaring all obligations of each Guarantor hereunder or thereunder immediately due and payable.**

8. Remedies Available**.**

The remedies of Lender, as provided herein or in any Total Loan Document, shall be cumulative and concurrent, and may be pursued singularly, successively or together, at the sole discretion of Lender, and may be exercised as often as occasion therefor shall arise. No act of omission or commission of Lender, including specifically any failure to exercise any right, remedy or recourse, shall be deemed to be a waiver or release of the same, and any waiver or release with reference to any one event shall not be construed as continuing or as a bar to, or as a waiver or release of, any subsequent right, remedy or recourse as to a subsequent event.

9. Agreement to Pay Attorneys' Fees and Expenses**. In the event that any Guarantor should default under any of the provisions of this Agreement and Lender should employ attorneys or incur other expenses for the collection of amounts guaranteed hereby or observance of any obligation or agreement on the part of any Guarantor contained in this Agreement, each Guarantor, on demand therefor, shall jointly and severally indemnify Lender against, and reimburse Lender for, reasonable fees of such attorneys and all such other expenses so incurred.**

10. **Effect of Waiver.**

No failure to exercise, and no delay in exercising any right, power or remedy hereunder or under any Total Loan Document shall impair any right, power or remedy which Lender may have, nor shall any such delay be construed to be a waiver of any of such rights, powers or remedies, or an acquiescence in any breach or default under this Agreement or any other Total Loan Document, nor shall any waiver of any breach or default of any Guarantor hereunder or under any other Loan Document be deemed a waiver of any default or breach subsequently occurring. The rights and remedies herein specified are cumulative and not exclusive of any rights or remedies which Lender would otherwise have.

11. **Subordination of Certain Debt/Waivers.**

Each Guarantor hereby represents, warrants and covenants that it has full power, authority and right to execute, deliver and perform its obligations pursuant to this Agreement and to keep and observe all of the terms of this Agreement. Each Guarantor hereby further represents, warrants and covenants as follows:

(a) _________________ is a corporation duly organized and validly existing under the laws of the State of _________. Every other Guarantor is a limited liability company duly organized and validly existing under the laws of the State of ___________.

(b) The execution, delivery and performance of this Agreement and the consummation of the transactions contemplated hereby: (i) do not require the approval or consent of any governmental authority having jurisdiction over any Guarantor or its property; (ii) do not and will not constitute a violation of, or default under, any applicable requirement of a governmental authority; and (iii) will not be in contravention of any court or administrative order or ruling applicable to any Guarantor or the property secured by any of the Second Mortgages, or any mortgage, indenture, operating agreement, charter document, agreement, commitment or instrument to which any

Guarantor is a party or by which it or its assets are bound, nor create or cause to be created any mortgage, lien, encumbrance, or charge against the assets of any Guarantor.

(c) There are no actions, suits or proceedings pending, or, to the best knowledge of each Guarantor, threatened, nor any pending or, to the best knowledge of each Guarantor, threatened labor disputes, against or affecting any Guarantor or the property secured by any of the Second Mortgages, at law or in equity, or before or by any governmental authority, which, if adversely determined, could, in the reasonable determination of Lender, either individually or in the aggregate, have a material adverse effect on the ability of any Guarantor to satisfy the Guaranteed Obligations.

(d) This Agreement is the legal, valid and binding obligation of each Guarantor, and is not subject to any right of rescission, set-off, counterclaim or defense, including the defense of usury, nor would the operation of any of the terms of this Agreement or the exercise of any right thereunder, render this Agreement unenforceable, in whole or in part, or subject to any right of rescission, set-off, counterclaim or defense, including the defense of usury.

(e) No default has occurred that is continuing in the performance of any obligation of any Guarantor which would be deemed an Event of Default under the Total Loan Documents.

Within ten (10) days after request by Lender, each Guarantor shall furnish Lender with a certificate reaffirming all representations and warranties of such Guarantor set forth herein as of the date requested by Lender or, to the extent of any changes to any such representations and warranties, so stating such changes.

13. Releases of Property**.**

(a) Upon payment in full of the indebtedness evidenced by a particular Note (the "Subject Note"), Lender shall release the First Mortgage and the Second Mortgage applicable to that particular Property, provided that (a) at the time of such

payment there shall not be a breach of any covenant or agreement of any Guarantor contained in any of the Total Loan Documents, and (b) the Affiliated Guarantor seeking such release shall pay the amount of any deferred financing fee, exit fee and/or prepayment premium, if any, due under the Subject Note, plus the greater of (1) ninety-five percent (95%) of the Net Proceeds (as hereinafter defined) or (2) one hundred twenty-five percent (125%) of the then unpaid principal amount of the indebtedness evidenced by the Subject Note, and (c) upon such release, the Guarantor shall, in the sole determination of Lender, be maintaining a Debt Service Coverage Ratio (as hereinafter defined) of not less than 1.40:1.00. The surplus remaining after such payment of the indebtedness relating to the Subject Note shall be applied to the Aggregate Debt governed by the Total Loan Documents other than those loan documents pertaining to the Loan evidenced by the Subject Note (such balance of the Total Loan Documents being hereinafter referred to as the "Other Loan Documents") in such order as Lender may determine.

(b) As used in this Section: "Net Proceeds" shall mean the gross value of all consideration received in connection with a sale, transfer, sale-leaseback or other disposition of the Property or Properties whose release is being sought, including cash consideration, notes, assumed indebtedness, deferred payments (contingent or otherwise), prepaid expenses, non-customary pro-rations in favor of the seller, and otherwise (or if in Lender's determination, such gross proceeds are not reflective of the consideration that would have been paid in a third-party transaction, the appraised value of such Property pursuant to an appraisal commissioned by Lender), or the gross financing proceeds in connection with any refinancing of the Subject Note, in each case less the reasonable and customary costs and expenses of such transfer or refinancing (including broker's commissions) not to exceed in the aggregate three percent (3%) of the gross transfer or refinancing proceeds; "Debt Service Coverage Ratio" shall mean the ratio of (i) the Revenues net of Expenses of all parcels of the Total Property that shall remain encumbered by the Other Loan Documents after such releases, divided by (ii) the aggregate of the annual amounts which Guarantors must expend to make all of the payments that are to be made to the Lender under the Other Loan Documents relating to

such remaining parcels of the Total Property as they become due and payable without penalty or additional interest, as such calculation of Debt Service Coverage Ratio is made in accordance with the terms and provisions of the Other Loan Documents; "Revenues" shall mean all of the revenues, rent, proceeds, profits and avails of whatever kind or character, from any source, of all parcels of the Total Property that shall remain encumbered by any Other Loan Document after such release, but excluding the gross proceeds of any insurance coverages available to Guarantors and any award for the condemnation or any conveyance in lieu thereof, as determined from time to time in accordance with the Other Loan Documents; and "Expenses" shall mean the total of the costs and expenses of operating, maintaining, protecting, and repairing all parcels of the Total Property that shall remain encumbered by any Other Loan Document after such release, as determined from time to time in accordance with the Other Loan Documents. Both Expenses and Revenues shall be determined on a cash rather than accrual basis, and shall be determined in accordance with the Other Loan Documents.

(c) In order to obtain a release hereunder, the chief financial officer of _________ shall furnish to Lender at least thirty (30) days prior to the requested release date, a certification which shall specify the requested or anticipated release date, shall certify that all the terms and conditions required herein or in any of the Other Loan Documents are satisfied, and shall include a detailed calculation of _________'s determination of the Debt Service Coverage Ratio (including detailed information regarding net property revenues, expenses and debt service) of the Total Property both before and after the proposed release, accompanied by such evidence and backup or other documentation as may be required by Lender in order for Lender to determine, in its sole discretion, whether the calculations in such officer's certification are accurate.

(d) Any release of the First Mortgage and the Second Mortgage with respect to any one parcel of the Total Property shall not in any event prevent or impair Lender from enforcing all of its rights and remedies with respect to any other parcel of the Total Property. Guarantors shall pay Lender's actual costs and expenses incurred in releasing the First Mortgage and the Second Mortgage. Lender shall

not be obligated to release any parcel of the Total Property unless and until Guarantors have strictly complied with the provisions of this Section.

14. Entire Agreement**.**

This Agreement constitutes the entire agreement between Guarantors and Lender with respect to the matters referred to herein, and no modification or waiver of any of the terms hereof shall be effective unless in writing, signed by the party to be charged with such modification or waiver. The preceding sentence is not meant to and shall not limit in any way the continuing force and validity of each of the guaranty agreements and environmental indemnity agreements entered into by __________ and/or an Affiliated Guarantor at the time of and in connection with the closing of a particular Loan to that Affiliated Guarantor.

15. Successors and Assigns/Assignment**.**

This Agreement shall inure to the benefit of Guarantors, Lender and their permitted successors and assigns and any subsequent holder of the Total Loan Documents and shall be binding upon each of the Guarantors, Lender and their permitted successors and assigns. No Guarantor shall be permitted to assign this Agreement without the prior written consent of Lender. Lender may assign this Agreement without the consent of any Guarantor.

16. Governing Law**.**

This Agreement shall be governed by the laws of the State of __________ without regard to conflicts of laws principals.

17. Joint and Several Obligations**. The obligations and liabilities of the Guarantors hereunder shall be joint and several.**

18. **Waiver of Jury Trial**.

TO THE FULLEST EXTENT PERMITTED BY LAW, GUARANTORS AND LENDER EACH HEREBY IRREVOCABLY WAIVES TRIAL BY JURY IN ANY ACTION, COUNTERCLAIM OR JUDICAL PROCEEDING BROUGHT BY GUARANTORS OR LENDER INVOLVING, DIRECTLY OR INDIRECTLY, ANY MATTER IN ANY WAY ARISING OUT OF, RELATED TO, OR IN CONNECTION WITH THIS INSTRUMENT, THE LOAN, THE LOAN DOCUMENTS, AND ANY ACTS OR OMISSIONS OF GUARANTORS OR LENDER IN CONNECTION THEREWITH.

19. **Notices**.

Any notice, demand, statement, request, consent or other communication made hereunder shall be in writing and shall be deemed given (a) on the next Business Day if sent by Federal Express or other reputable overnight courier and designated for next Business Day delivery, (b) upon delivery, if delivered in person or by facsimile transmission with receipt acknowledged by the recipient thereof, or (c) on the third (3rd) Business Day following the day such notice is deposited with the United States postal service first class certified mail, return receipt requested, addressed to the address, as set forth above, of the party to whom such notice is to be given (with notices to __________ being sufficient for notices to each of the individual Guarantors), or to such other address or additional party as ____________ or Lender, as the case may be, shall in like manner designate in writing. Any notice to Guarantors shall be likewise given to _______, _______, ______, _________, to the attention of _________, Esq. Any notice to Lender shall be likewise given to (i) ______________, _________________, ___________________, to the attention of _______, and (ii) _________________, ________________,________________, to the attention of______________, Esq.

20. **Severability**.

Wherever possible, each provision of this Agreement shall be interpreted in such manner as to be effective and valid under applicable law, but if any provision of this Agreement shall be prohibited by or be invalid under applicable

law, such provision shall be ineffective to the extent of such prohibition or invalidity, without invalidating the remainder of such provision or the remaining provisions of this Agreement.

21. **Time of Essence**.

Time is of the essence of this Agreement and of each and every term, covenant and condition herein.

22. **No Third-Party Lender Rights Created**.

The parties hereto expressly declare that it is their joint and mutual intention that this Agreement and the transactions contemplated hereby shall not be construed as creating a third-party Lender contract, and this Agreement shall not be construed as giving or conferring any rights or benefits whatsoever to or upon any other persons or entities other than Guarantors and Lender.

IN WITNESS WHEREOF, Guarantors have executed and delivered this Agreement under seal as of the day and year first above written.

GUARANTORS:

_____________________, a

_____________ corporation

By:________________(seal)

Name:__________________

Title:___________________

[INSERT NAMES OF ALL ______________ PROPERTY OWNERS/GUARANTORS]

Schedule 1

	ro pe rty	Guarantor	**Loan Amount**	**Guaranty Ceiling**

EXHIBIT "B"

LIMITED GUARANTY LANGUAGE

Subsidiary hereby guarantees such portion of Parent's indebtedness as would not constitute a fraudulent transfer or conveyance under all applicable state fraudulent conveyance, federal bankruptcy, state insolvency or similar creditors' rights laws.

EXHIBIT "C"

No Fraudulent Conveyance

Notwithstanding any contrary provision contained in this Agreement, Guarantors, and by its acceptance hereof, Lender, hereby confirm that it is their intention that the obligations of each Guarantor hereunder shall not constitute a fraudulent transfer or obligation for the purposes of the Bankruptcy Code and applicable state law, including any state law based on the Uniform Fraudulent Transfer Act or the Uniform Fraudulent Conveyance Act. To effectuate the foregoing intention, Lender irrevocably agrees that the aggregate liability of each Guarantor under this Agreement shall in no event exceed, at any time, ninety-five percent (95.0%) of the "Net Asset Value" (as hereafter defined). As used herein, the term "Net Asset Value" means (x) the fair saleable value of the assets, on a going concern basis, of each Guarantor as determined from time to time, minus (y) the total fair value of the bona fide liabilities of such Guarantor (including contingent liabilities, but excluding liabilities of such Guarantor under this Agreement) as determined from time to time but on the same date the value of the assets is determined pursuant to (x) above. In no event will payments made by each Guarantor be returned by virtue of a subsequent decrease in the Net Asset Value.

EXHIBIT “D”

AFFIDAVIT AND CERTIFICATE

On the _____ day of___________, _____, ___________________ and ___________________, in their capacities as, respectively, President and Chief Financial Officer of ___________________, Inc. (collectively, “Affiants”), being duly sworn, depose and say as follows:

1. Each of the entities shown on Schedule 1, attached hereto and made a part (each such entity being hereinafter referred to individually as an “LLC”), is a _______________ limited liability company. Affiants are, respectively, the President and Chief Financial Officer of ___________________, a _______________ corporation (“Company”), which is the direct or indirect owner of one hundred percent (100%) of the equity/membership interests in each LLC. In such respective capacities, Affiants are familiar with the affairs of Company and each LLC.

2. This Affidavit is given to ___________________ (“Lender”) in connection with the execution and delivery of that Cross Guaranty Agreement dated as of _______________, by each of the LLC's for the benefit of Lender (the “Cross Guaranty Agreement”). The Cross Guaranty Agreement is secured by a second mortgage or deed of trust to be filed against the respective property owned by each LLC (the “Second Mortgages”). Each of the original Mortgages (as hereinafter defined) is being amended by certain amendments to mortgage or deed of trust (the "Mortgage Amendments”) to delete certain provisions from each such Mortgage (the Cross Guaranty Agreement, the Second Mortgages, the Mortgage Amendments and the other documents executed and delivered to Lender in connection therewith are hereinafter referred to as the "New Loan Documents”). Affiants intend that Lender and its transferees, successors, assigns and participants may rely on the representations set forth in this Affidavit in connection with the consummation of the transactions described in the Cross Guaranty and other New Loan Documents.

3. Each LLC has previously received a Loan from Lender, as described on Schedule 1, evidenced by a certain promissory note dated as of even date as the closing of the Loan (the "Note"), secured by, among other things, a mortgage or deed of trust of even date therewith (the "Mortgage") and guaranteed by a certain Guaranty Agreement of even date therewith (the "Guaranty") from the respective LLC and Company for the benefit of Lender. (The Note, Mortgage, Guaranty and all other documents executed by each LLC and delivered to Lender in connection with the Loan are hereinafter collectively referred to as the “Original Loan Documents"). All capitalized terms used herein without definition shall have the meaning ascribed to such terms in the Mortgage.

4. The Affiants hereby further represent that to their best knowledge and belief: Each LLC is the fee simple owner of the Property described in the Mortgage to which it is a party, which Property is located in the City ascribed to such LLC on Schedule 1 hereto.

5. The Afl'iants hereby further represent that to their best knowledge and belief: All statements, representations and warranties contained in the Original Loan Documents or in any other material writing previously delivered by Company or an LLC to Lender in connection with each Loan are true and correct in all material respects.

6. The Affiants hereby further represent that to their best knowledge and belief: There have been no material adverse changes, financial or otherwise, in the condition of Company or any LLC from that disclosed to Lender at the time of the making of each Loan or as most recently submitted to Lender.

7. The Affiants hereby further represent that to their best knowledge and belief: There is no material claim, investigation, litigation or condemnation proceeding pending or, to the best of knowledge of Affiants, threatened against any Property owned by Company or an LLC, except as heretofore disclosed in writing to Lender.

8. The Affiants hereby further represent that to their best knowledge and belief: There is no judgment, decree or order of any court or governmental or administrative agency or instrumentality which has been issued against any LLC or Company and which has or could reasonably be expected to have any material effect on the Property or on the business of such LLC or Company, except as have been heretofore disclosed to Lender in writing.

9. The Affiants hereby further represent to their best knowledge and belief: The books and records of Company and each LLC have been maintained in the regular course of business and in accordance with generally accepted accounting principles consistently applied. Each LLC and Company is solvent, and Affiants know of no fact, or pending or threatened claim or litigation that might result in the insolvency or bankruptcy of any LLC or Company. Entering into the Cross Guaranty, the Second Mortgage and the other New Loan Documents, and the consummation of the transactions described therein will not render any LLC or Company insolvent. As used in the Affidavit and Certificate, the term "insolvent" means that the sum total of all of an entity’s liabilities (whether secured or unsecured, contingent or fixed, or liquidated or unliquidated) is in excess of the value of all such entity’s assets. Attached hereto as Schedule 1 is a true and accurate list of the maximum original principal amount of all indebtedness currently owing by all LLC’s to Lender. Attached hereto as Schedule 2 is a true and accurate list of all secured indebtedness and liabilities of any kind or character (other than that indebtedness held by Lender) currently owing by any of the LLC’s and/or by Company. Attached hereto as Schedule 3 is a true and accurate list of all equipment leases and all unsecured indebtedness liability (other than trade debt), of every kind and character, currently owing by any of the LLC’s and/or by Company. Attached hereto as Schedule 4 is a true and accurate list of all trade indebtedness and liabilities currently owing by any of the LLC's and/or Company, other than trade debt incurred in the ordinary course of business by any such LLC, not exceeding, as to such LLC, Ten Thousand Dollars ($10,000.00) and in the aggregate as to all such LLC’s and Company, __________ Dollars ($__________.00).

10. The Affiants hereby further represent that to their best knowledge and belief: Attached hereto as Schedule 5 is a true and accurate list of the Remaining Secured Property (as defined in the Cross Guaranty Agreement), broken into its three respective components as of the date hereof: (i) those parcels where either a final certificate has not been issued or has been issued less than three (3) months prior to the date hereof; (ii) the Newly Opened Properties (as defined in the Cross Guaranty Agreement); and (iii) the Stabilized Properties (as defined in the Cross Guaranty Agreement). As of the date hereof, the Debt Service Coverage Ratio (as defined in and calculated pursuant to the Cross Guaranty Agreement) for the Newly Opened Properties over the twelve (12) month period immediately preceding that date hereof, is not less than 1.20:1.00, and the Debt Service Coverage Ratio of the Stabilized properties, over the twelve (12) month period immediately preceding the date hereof, is not less than 1.40:1.00.

11. The Affiants hereby further represent that to their best knowledge and belief: The undersigned, on behalf of each LLC and Company, acknowledge and agree that the execution and delivery of the Second Mortgage, the Cross Guaranty, the Mortgage Amendments and the other New Loan Documents executed in connection herewith shall not affect or impair in any manner the continuing legal force and effect oft remain in full force and effect of the Original Loan Documents, all of which remain in full force and effect. Without limiting the generality of the foregoing, the undersigned, on behalf of each LLC and Company, acknowledge and agree that it is their current intention and belief (which have been well considered following advice and consultation with competent counsel) that a bankruptcy claim or challenge to any such New Loan Document shall not affect or impair the continuing validity, enforceability and priority of the Mortgage, the original Guaranty Agreement or any other Original Loan Documents.

12. The Affiants hereby further represent that to their best knowledge and belief: There exists good and valuable and sufficient consideration which each LLC is receiving from Lender in return for entering into the Cross Guaranty Agreement and the other New Loan Documents, including without limitation, clarifying under what circumstances and at what price the secured properties owned by each LLC may be released from the liens and security interests held by Lender pursuant to the Mortgage and the other Original Loan Documents.

13. The undersigned, on behalf of each LLC and Company, hereby acknowledge that they are sophisticated and experienced in the field of real estate acquisition, development, construction, operation and financing. The undersigned, on behalf of each LLC and Company, hereby acknowledge that it or he was adequately represented by competent counsel of its or his choice in respect to the Loan and the Original Loan Documents and the transactions contemplated therein, and in connection with the Cross Guaranty, the Second Mortgage and the other New Loan Documents and the transactions contemplated therein. Each of the undersigned has reviewed with such counsel, and understands and approves, the terms of the New Loan Documents.

14. The undersigned have undertaken the necessary investigations and determinations of the matters set forth herein, and are delivering this Affidavit and Certificate solely in their capacity as officers of Company on the express condition that neither of the undersigned shall have any personal liability hereunder whatsoever. Further, neither of the undersigned is a licensed attorney, and neither of the undersigned is rendering any legal opinion herein, although the undersigned have discussed the matters set forth herein with legal counsel.

Affiants make this Affidavit for the purpose of inducing Lender to continue making loans to affiliates of Company.

WITNESS:	**AFFIANTS:**
	____________________ INC., a ____________________ corporation
____________________ Name: ______________	By: ____________________ Name: __________________ Title: President
____________________ Name: ______________	By: ____________________ Name: __________________ Title: Chief Financial Officer

SCHEDULE 1*

	Property	Guarantor	Loan Amount	Guaranty Ceiling
1.				
2.				
3.				
4.				
5.				
6.				
7.				
8.				
9.				
10.				
11.				
12.				
13.				
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18.				
19.				
20.				
21.				
22.				
23.				
24.				
25.				
26.				
27.				
28.				

* The parties to the Agreement acknowledge and agree that as additional loans are closed or released, they will re-execute revisions to this Schedule 1, as appropriate.

SCHEDULE 2

SCHEDULE 3

SCHEDULE 4

SCHEDULE 5

EXHIBIT "E"

CONTRIBUTION AGREEMENT

CONTRIBUTION AGREEMENT dated as of ________________, _____, among each of the limited liability companies and limited partnerships (collectively, the "Borrowers").

Reference is made to Indenture of Mortgage, Deed to Secure Debt, Security Agreement, Financing Statement, Fixture Filing and Assignment of Leases, Rents and Security Deposits dated as of the dat hereof (the "Mortgage") among the Borrowers, ________________________ (the "Lender") and ____________________ Title Insurance Company. Capitalized terms used herein and not defined herein shall have the meanings assigned to such terms in the Mortgage.

The Lender has agreed to make the Loan to the Borrowers pursuant to, and upon the terms and subject to the conditions specified in, the Mortgage.

Accordingly, the borrowers agree as follows:

Contribution and Subrogation. Each Borrower (a "Contribution Borrower") agrees that, in the event a payment shall be made by any other borrower with respect to an Event of Defualt with respect to any part of the principal amount of the Loan (the "Claiming Borrower") under the Mortgage (or assets of any claiming Borrower shall be sold pursuant to the Mortgagte or any other Loan Document) the Contributing Borrower shall indemnify the Claiming Borrower in an amount equal to the amount of such payment (or the greater of the book value or the fair market value of such assets, as the case may be, in each case) multiplied by a fraction of which the numerator shall be the Allocated Loam Amount of the Contributing Borrower on the date hereof and the denominator shall be the aggregate Loan Amoung on the date hereof.

Termination. This Agreement shall survive and be in full force and effect so long as any Indebtedness is outstanding and has not been indefeasibly paid in full in cash and shall continue to be effecive or be reinstated, as the case may be, if at any time payment, or any part thereof, of the Loan is rescinded or must otherwise be restored by the Lender upon the bankruptcy or reorganization of any Borrower or otherwise.

Governing Law. THIS AGREEMENT SHALL BE GOVERNED BY, AND CONSTURED IN ACCORDANCE WITH, THE LAWS OF THE STATE OF ____________________.

No Waiver; Amendment. (a) No failure on the part on any Borrower to exercise, and no delay in exercising, any right, power or remedy hereunder shall operate as a waiver thereof, nor shall any single or partial exercise of any such right, power or remedy by any Borrower preclude any other or further exercise thereof or the exercise of any other right,

power or remedy. All remedies hereunder are cumulative and are not exclusive of any other remedies provided by law. None of the Borrowers shall be deemed to have waiver any rights hereunder unless such waiver shall be in writing and signed by such parties.

Neither this Agreement nor any provision hereof may be waived, amended or modified except pursuant to a written agreement entered into between the Borrowers.

Notices. All communications and notices hereunder shall be in writing and given as provided in the Mortgage and addressed as specified therein.

Binding Agreement; Assignments. Whenever in this Agreement any of the parties hereto is referred to, such reference shall be deemed to include the successors and assigns of such party; and all covenants, promises and agreements by or on behalf of the parties that are contained in this Agreement shall bind and inure to the benefit of their respective successors and assigns. Notwithstanding the foregoing, at the time any Borrower is released from its obligations under the Mortgage in accordance with the terms thereof, such Borrower will cease to have any rights or obligations under this Agreement.

Counterparts. This Agreement may be executed in one or more counterparts, each of which shall be deemed to be an original, and all of which together shall constitute on and the same instrument.

IN WITNESS WHEREOF, the parties hereto have caused this Agreement to be executed by their duly authorized officers as of the date first appearing above.

EACH OF THE ENTITIES LISTED

ON

SCHEDULE I HERETO,

By:

____

Name:

____

Title: Authorized Officer

SCHEDULE I