

GUARANTIES AND FRAUDULENT TRANSFERS

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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]he 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” guaranty 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. A sample form of such a cross-collateralization agreement is attached hereto as **Exhibit "A."**

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 F.2d 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" (sample forms of which is attached hereto as **Exhibit "B"**), 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 “C,” “D,”** and **“E”**);

- (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 “F”**);
- (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 “G”**); 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.2d 198, 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).

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 "Bankruptcy Code"), 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

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 the 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 JUDICIAL 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]

EXHIBIT “B”

NET-WORTH LIMITATION OF INDEBTEDNESS

Notwithstanding anything to the contrary elsewhere contained herein or in any Loan Document to which Guarantor is a Party, the aggregate liability of Guarantor hereunder for payment and performance of the Guaranteed Obligations shall not exceed an amount which, in the aggregate, is \$100,000 less than that amount which, if so paid or performed, would constitute or result in a fraudulent transfer, fraudulent conveyance, or terms of similar import, under applicable state or federal law, including, without limitation, Section 548 of the United States Bankruptcy Code.

NET-WORTH LIMITATION OF INDEBTEDNESS (ALTERNATIVE)

Notwithstanding any other part of this loan agreement or other documents involved in this transaction, the maximum amount of this loan indebtedness, and the mortgage securing the loan indebtedness, shall be \$1000.00 less than the amount of indebtedness that would render the borrower insolvent under all applicable state fraudulent conveyance laws, federal bankruptcy laws, state insolvency laws 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”

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 "E"

Notwithstanding any provision herein contained to the contrary, Guarantor's liability under this Guaranty shall be limited to an amount not to exceed as of any date of determination the amount which could be claimed by Mortgagee from Guarantor under this Guaranty without rendering such claim voidable or avoidable under Section 548 of the Bankruptcy Code (Title 11, U.S.C.) or under any applicable state Uniform Fraudulent Transfer Act, Uniform Fraudulent Conveyance Act or similar statute or common law ("Avoidance Provisions") after taking into account, among other things, Guarantor's right of contribution and indemnification from each other Guarantor, if any. To the end set forth above, but only to the extent that the obligations of Guarantor hereunder ("Guaranty Obligations") would otherwise be subject to avoidance under the avoidance provisions, if Guarantor is not deemed to have received valuable consideration, fair value, fair consideration or reasonably equivalent value for the Guaranty Obligations, or if the Guaranty Obligations would render Guarantor insolvent, or leave Guarantor with an unreasonably small capital to conduct its business, or cause Guarantor to have incurred debts (or to have intended to have incurred debts) beyond its ability to pay such debts as they mature, in each case as of the time any of the Guaranty Obligations is deemed to have been incurred for the purposes of the Avoidance Provisions, the maximum Guaranty Obligations for which Guarantor shall be liable hereunder shall be reduced to that amount which, after giving effect thereto, would not cause the Guaranty Obligations as so reduced, to be subject to avoidance under the Avoidance Provisions.

EXHIBIT "F"

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 Affiants 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.				
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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 "G"

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 date 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 Default 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 Mortgage 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 Loan Amount of the Contributing Borrower on the date hereof and the denominator shall be the aggregate Loan Amount 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 effective 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 CONSTRUED 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 waived 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