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Otten Johnson Alert -

New York Court Enforces Springing Recourse Guaranty Despite One Action Rule

A recent New York trial court decision upheld a common full recourse trigger in a non recourse carve-out guaranty by holding that a voluntary bankruptcy filing by the borrower enabled the lender to seek immediate full repayment from the guarantor under the terms of the guaranty, even though the loan was subject to New York State's "one action rule" and the lender had pursued a foreclosure action against the property securing the loan.

In *172 Madison (NY) LLC v. NMP-Group LL, et al.*, 2013 N.Y. Slip Op. 51618(U), 2013 WL 5509141 (N.Y. Sup. Ct. Oct. 3, 2013), a successor to the lender (the "Lender") brought a foreclosure action following a monetary default by a borrower (the "Borrower") on a $29 million non-recourse real estate loan secured by property in midtown Manhattan. As part of the loan transaction, the borrower's principal (the "Guarantor") had executed a non-recourse carve-out guaranty (the "Guaranty"). In addition to the standard so-called "bad boy" provisions—fraud, waste, misappropriation of property income, etc.—the Guaranty contained "springing recourse" language which provided that the Guarantor would become personally liable for the full amount of the debt if the Borrower voluntarily filed for bankruptcy. After the Borrower defaulted, the Lender commenced a foreclosure action. The court entered a judgment of foreclosure and sale in favor of the Lender. On the day of the scheduled sale, however, the Borrower filed a voluntary petition for bankruptcy in federal bankruptcy court, automatically staying the sale. The Lender then filed a motion for summary judgment on the Guaranty, alleging that under the springing recourse provision, the Guarantor was now liable for the full amount of the debt.

Under New York's one action rule, while an action is pending or after final judgment for the plaintiff, no other action may be commenced to recover the debt without the permission of the court in which the original action was brought. The Guarantor in this case argued that because the Lender had elected one remedy, foreclosure, it was barred from changing course and pursuing another, through an action under the Guaranty.

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The court disagreed. Quoting another opinion, it stated that "[t]he election of remedies doctrine only operates when there was a choice of remedies available at the time prior actions were undertaken." The court held that the one action rule did not bar the Lender's action under the Guaranty because at the time the Lender filed for foreclosure, the Borrower had not yet filed for bankruptcy, meaning that the Guarantor had not yet become personally liable for the debt pursuant to the Guaranty. The Lender therefore had only the foreclosure remedy, not a "choice of remedies" from which to make an election. As the court pointed out elsewhere in the opinion:

> *In exchange for agreeing to look only to the mortgaged property in the event of default, lenders typically require that the borrower or its guarantor promise to pay the entire debt if they impede foreclosure by filing for bankruptcy. It can be said without exaggeration that the Guaranty was intended to apply to the exact circumstance currently confronting Lender.*

Accordingly, the court granted the Lender's motion for summary judgment on the Guaranty claim and allowed the Lender to proceed against the Guarantor. The one action rule was not completely ineffective here; the court ordered that the Lender would have to apply for a new order and judgment, either to proceed with the foreclosure (subject to getting relief from the bankruptcy stay) but with a reservation of the right to seek a deficiency against the Guarantor, or to substitute in place of the foreclosure order an order for a money judgment against the Guarantor.

This holding is obviously of most relevance with respect to loans that are governed by the laws of states with some variation on the one action rule. Colorado is not one of those states. However, the case also demonstrates the willingness of courts generally to enforce springing recourse provisions, notwithstanding the significant impact of these provisions on guarantors. As the court in this case stated, "To hold otherwise would undermine the widespread and settled use of nonrecourse loans subject to guaranties triggered by certain springing recourse events. The court is unwilling to upend the universe of real estate finance for [the sake of this Guarantor]." When drafting and negotiating guaranties, Lenders should have confidence in the enforceability of language providing that a borrower's voluntary bankruptcy filing triggers full recourse liability—and guarantors should take such potential full recourse liability very seriously.

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