Fordham Journal of Corporate & Financial Law

Volume 20 | Issue 3 Article 6

2015

The Invocation of § 105 to Bar the Enforcement of Springing Guaranties Triggered by Bankruptcy-Related Events

Chanel Van Dyke

VOLUME XX 2015 NUMBER 3

FORDHAM

JOURNAL OF

CORPORATE & FINANCIAL LAW

THE INVOCATION OF § 105 TO BAR THE ENFORCEMENT OF SPRINGING GUARANTIES TRIGGERED BY BANKRUPTCY-RELATED EVENTS

Chanel Van Dyke

THE INVOCATION OF § 105 TO BAR THE ENFORCEMENT OF SPRINGING GUARANTIES TRIGGERED BY BANKRUPTCY-RELATED EVENTS

Chanel Van Dyke[*]

ABSTRACT

This Note addresses the relatively recent phenomenon of springing guaranties, albeit only in the context of their effect on bankruptcy's traditional reorganization process. As such, this Note targets springing guaranties triggered by bankruptcy-related events. Unfortunately, the threat of liability posed by such springing guaranties creates perverse incentives for the guarantor. This is problematic because lenders only employ springing guaranties if the guarantor is an insider of the borrower who has the capacity to wield significant decision-making authority. Although directors of a solvent corporation only owe fiduciary duties to shareholders, this obligation broadens to encompass creditors, as well as shareholders, as the corporate entity approaches insolvency. It is incumbent upon the directors to take a more holistic approach in making decisions so as to consider the welfare of the corporate entity as a whole, as opposed to merely the individual stakeholders. Once in bankruptcy, the debtor in possession ("DIP") owes these duties to the estate, thus coming full circle in favor of the holistic approach. In contrast, the springing guaranty device encourages the insider-guarantor to make decisions based on an inverted approach. As the company approaches insolvency and all the signals indicating that it is time to authorize a bankruptcy align, the existence of the springing guaranty discourages the guarantor from adopting the holistic approach. Instead of paying heed to the signals and accordingly adopting the

* J.D. Candidate, 2015, Fordham University School of Law, B.A. in Government & International Relations Certificate at Wesleyan University, Middletown, Connecticut. Many thanks to The Honorable Michael B. Kaplan for his invaluable insight on the subject, to Professor Foteini Teloni for her helpful and thorough feedback throughout the writing process, to the staff and Editorial Board of the Fordham Journal of Corporate & Financial Law for their much-appreciated assistance, and to my family and friends for their constant encouragement in writing this Note.

approach most likely to maximize the value of the corporate entity, the springing guaranty incentivizes the guarantor to adopt an individualistic approach that favors the guarantor's own interests at the expense of the corporate entity's interests. This manifests itself in the guarantor's delayed authorization of a bankruptcy filing despite the fact that all objective indicators suggest that the guarantor should have timely authorized the filing. Eventually, the guarantor is left with no choice but to authorize the filing. However, at that point, the delay has taken its toll on the corporate debtor, so its prospects of undergoing a successful reorganization are substantially diminished. The springing guaranty device is the culprit behind the guarantor's skewed decision-making process and the subsequently diminished viability of the borrower upon entering bankruptcy. For that reason, this Note takes the position that in appropriate cases, bankruptcy courts should invoke their equitable powers to enjoin the enforcement of detrimental springing guaranties.

TABLE OF CONTENTS

INTRODUCTION 787
I. PROCEDURAL AND SUBSTANTIVE BACKGROUND 791
A. The Subject Matter Jurisdiction of the Bankruptcy Court....... 791
B. The Springing Guaranty Device and the Problems It Entails.. 794
II. THE CONFLICT OVER WHETHER TO ENFORCE SPRINGING GUARANTIES AND WHAT COURT SHOULD BE THE COURT TO ENFORCE THEM 798
A. The Jurisdictional Conflict 798
B. Reframing the Substantive Issue to Resolve the Jurisdictional Bar 810
C. The Substantive Conflict Over Enforcement of the Springing Guaranty 816
1. Arguments in Favor of Enforcement 816
2. Arguments Against Enforcement 821
3. Synthesis of the Existing Case Law and Legislation 824
a. The Circuits 824
b. The Factors 837
III. SOLUTION TO THE JURISDICTIONAL CONFLICT, SUBSTANTIVE REFRAMING AS A SOLUTION, AND SOLUTION TO THE SUBSTANTIVE CONFLICT 838
A. Jurisdictional Solutions: "Core," "Arising In" Jurisdiction and "Non-Core," "Related To" Jurisdiction 838
B. Exploring Guarantor's Ability to Confer "Arising Under" Jurisdiction Exclusively on a Bankruptcy Court and to

Eliminate the Jurisdictional Bar Posed by the Doctrine of Mandatory Abstention ... 841
C. Invocation of § 105 to Bar Enforcement of a Springing Guaranty ... 850
1. The Bankruptcy Code Provisions and their Policies May Support the Use of § 105 to Bar Enforcement of Springing Guaranties ... 850
2. Why a Bankruptcy Court is Justified in Invoking its Equitable Powers Pursuant to § 105 ... 861
a. Temporary v. Permanent Injunctions ... 861
b. Section 105 Temporary Injunctions ... 862
i. The Five-Factor Test: When to Issue an Injunction Pursuant to § 105 ... 862
1. Identity of Interests ... 863
2. Contribute "Substantial" Assets ... 864
3. Essential to the Reorganization ... 866
4. Agreement by Substantial Majority of Creditors ... 867
5. Payment of Claims Held by Impacted Class ... 867
ii. The Five-Factor Test: Application in the Springing Guaranty Context ... 868
1. Application: Identity of Interest ... 869
2. Application: Contribute "Substantial" Assets ... 871
3. Application: Essential to the Reorganization ... 872
4. Application: Agreement by Substantial Majority of Creditors ... 873
5. Application: Payment of Claims Held by Impacted Class ... 874
c. Section 105 Permanent Injunctions ... 876
d. Per Se Rule v. Case-by-Case Approach ... 877
CONCLUSION ... 881
EXHIBIT 1: CASE STUDY ... 884
EXHIBIT 2: THE ABILITY OF GUARANTORS TO INFLUENCE DEBTORS ... 887
EXHIBIT 3: SURVEY OF SPRINGING GUARANTY CASES ... 888

INTRODUCTION

Lenders generally feel that the provisions of Chapter 11 of the Bankruptcy Code (the "Code") favor the borrower-debtor and have the potential to cause the lender-creditor to suffer substantial losses.[1] For this reason, lenders will be more likely to include "hindrance mechanisms" in their loan documents, where the borrower's corporate structure limits the assets accessible to the lender upon the borrower's default or where, as a whole, the economy is in a state of decline.[2] "Hindrance mechanisms" refer to tactics lenders employ to deter a struggling company from filing a Chapter 11 petition and thereby gaining the protections afforded to the debtor under the Code.[3]

One such "hindrance mechanism" is a personal guaranty, commonly referred to as a springing guaranty.[4] Lenders require the inclusion of springing guaranties in the loan documents of certain corporate borrowers, particularly those that the lenders view as riskier investments due to their limited liability structure and their involvement

---

1. *See* Alfred G. Adams, Jr. & Jason C. Kirkham, *The Real Estate Lender's Updated Guide to Single Asset Bankruptcy Reorganizations*, 8 DEPAUL BUS. & COM. L.J. 1, 17 (2009) (discussing how borrowers traditionally filed bankruptcy and threatened a "cramdown" under § 1129(a)(8) as a means to gain leverage over the lender); *see also* Joshua L. Eisenson, *Exploring the Enforceability of Pre-Petition Hindrance Mechanisms to Prevent Bankruptcy*, 22 AM. BANKR. INST. L. REV. 247, 247 (2014) (discussing how lenders combat bankruptcy filings by the borrower through the imposition of a financial disincentive against filing upon the guarantor).

2. Adams, Jr. & Kirkham, *supra* note 1, at 1-2 (discussing the need for springing guaranties in the context of economic downturns and single-asset borrowers); Michael D. Felding, *Preventing Voluntary and Involuntary Bankruptcy Petitions by Limited Liability Companies*, 18 Bankr. Dev. J. 51, 51-52 (discussing the interrelation between a lender's use of hindrance mechanisms and a borrower's LLC corporate structure).

3. Eisenson, *supra* note 1, at 247.

4. *Id.* at 262 n. 106 (referring to the terms bad boy guaranty and springing guaranty as synonyms). The term *springing guaranty* is closely related to similar devices that effectuate the same result with slight variations in the manner in which they do so. *See* Marshall E. Tracht, *Will Exploding Guaranties Bomb?*, 117 BANKING L.J. 129, 129 (March/April 2000) [hereinafter *Will Exploding Guaranties Bomb?*] (differentiating between a springing guaranty and an exploding guaranty, while noting that the effect of both devices is the same). The terms for these similar devices are often used synonymously with the term springing guaranty and include bad boy guaranty, exploding guaranty, nonrecourse carve-out, and recourse obligation. *See* Adams, Jr. & Kirkham, *supra* note 1, at 6-7 (using the terms springing, exploding, and non-recourse carve-out guaranties interchangeably); Lauren Beslow & Travis Eliason, *Commercial Loan Guaranties and Enforcement of Non-Recourse Carve-Out Liability*, 20 No. 13 WESTLAW J. BANK & LENDER LIAB. 1, at *1-2 (2014) (distinguishing a springing guaranty from the similar device of a bad-boy guaranty or non-recourse carve-out guaranty).

in the single asset real estate business.[5] To avoid potentially devastating losses should such risk-prone borrowers file for bankruptcy, these lenders require an insider of the corporate borrower to sign a guaranty agreement.[6] The guaranty agreement obligates the insider-guarantor to assume full or partial recourse liability under the loan document upon the borrower's default.[7] The guaranty agreement, via a reference to the borrower's loan agreement, enumerates the conditions that trigger the guarantor's liability thereunder.[8] Bankruptcy-related events are commonly included within the "Fatal Four" default events triggering full recourse liability to a guarantor.[9] More specifically, the triggering condition that requires the guarantor to assume all obligations of the borrower upon the borrower's voluntary filing for bankruptcy protection is arguably the most problematic condition in these loan contracts.[10] At

---

5. *See* Adams, Jr. & Kirkham, *supra* note 1, at 2 (connecting the recent increase in defaults by commercial real estate borrowers to a single type of borrower: special purpose entities that own a single real estate project).

6. *See Will Exploding Guaranties Bomb?*, *supra* note 4, at 129 ("A springing guaranty is a guaranty of an enterprise's debt, given by an insider, which will become effective only upon specified conditions.").

7. Gary E. Fluhrer, Scott B. Osborne, James H. Wallenstein & Susan G. Talley, "Nonrecourse Carveout Guaranties in Commercial Loans: Drafting Tips to Avoid Unintended Liabilities," *ALI CLE Commercial Real Estate Financing: Structuring and Documenting Transactions in a Reviving Market* 1 (June 2014).

8. *Id.* at 2 ("[T]he guarantied [sic] obligations are the recourse events to the borrower set forth in the promissory note and incorporated by reference in the carve-out guaranty.").

9. Daniel K. Wright, II, Thomas W. Coffey, James H. Schwarz & Paul S. Magy, *Non-Recourse Carve-Outs, "Bad-Boy" Guaranties, and Personal Liability After Cherryland: Strategies to Resolve Lender and Guarantor Disputes in and Outside of Bankruptcy*, STRAFFORD 15 (Jan. 30, 2014) (defining two of the four main triggering conditions to be the borrower's voluntary bankruptcy filing and the borrower's involuntary bankruptcy filing caused by collusion with the borrower's unsecured creditors).

10. *See* Adams, Jr. & Kirkham, *supra* note 1, at 12 (identifying springing guaranties triggered by bankruptcy filings as the largest impediment to borrower bankruptcies). Although there are various potential triggering conditions contained in loan agreements of the nature described herein, the substantive part of this note will only address cases, wherein the filing of a bankruptcy petition is what triggers recourse liability against the guarantor. *See* Parts I.B, II.C & III.C. The jurisdictional parts of this note are necessarily not as narrow in scope due to the limited number of springing guaranty cases that address the jurisdictional issue, regardless of what the triggering condition was that caused the guaranty to "spring" into effect. *See infra* Parts I.A, II.A,

least one commentator limits the definition of a springing guaranty to guaranties triggered by bankruptcy-related events, as opposed to the traditional triggering events that constitute the borrower's bad acts.[11]

Preliminarily, this Note advocates for the bankruptcy court's retention of springing guaranty proceedings triggered by bankruptcy-related events on three jurisdictional grounds.[12] First, such proceedings can only "arise in" the context of a bankruptcy case.[13] Second, these claims are sufficiently "related to" the underlying bankruptcy case to support the bankruptcy court's jurisdiction.[14] Third, the insider-guarantor could act through the debtor in order to confer upon the bankruptcy court jurisdiction over the springing guaranty issue.[15] This Note's primary argument is a proposal to the substantive conflict over springing guaranties: the bankruptcy court should rely on its equitable

---

II.B, III.A, III.B. The scope of this note is also limited to filings by corporate debtors under Chapter 11 of the Bankruptcy Code.

11. *See* Beslow & Eliason, *supra* note 4, at *1-2 (differentiating a bad boy guaranty from a springing guaranty based on the triggering condition leading to the borrower's default under the loan agreement). The implication is that since bankruptcy filings are not necessarily bad acts of the borrower, it is inappropriate to include guaranties triggered by bankruptcy filings within the definition of a bad boy guaranty. *Id.* at *2.

12. *See* 28 U.S.C. § 1334(a) (2012) (defining the jurisdiction of the district courts over all bankruptcy cases and proceedings); *see also id.* § 157(a) (permitting the districts courts to refer all bankruptcy cases or proceedings to the bankruptcy courts).

13. *See id.* § 1334(b) (providing the district courts with original but not exclusive jurisdiction over all civil proceedings "arising in" a bankruptcy case); *see also id.* § 157(a) (permitting the district court to refer all proceedings "arising in" a bankruptcy case to the bankruptcy court).

14. *See id.* § 1334(b) (providing the district courts with original but not exclusive jurisdiction over all civil proceedings "related to" a bankruptcy case); *see also id.* § 157 (permitting the district court to refer all proceedings "related to" a bankruptcy case to the bankruptcy court).

15. If, at the time the debtor files its petition, it also files a motion to modify the automatic stay on behalf of its guarantor, then the springing guaranty issue will "arise under" § 362 of the Bankruptcy Code. *See* 11 U.S.C. § 362(a) (barring creditor claims against the debtor so as to afford the debtor the opportunity to attempt a reorganization plan free from the financial pressures that drove the debtor into bankruptcy); *see also* 28 U.S.C. § 1334 (providing the district courts with original but not exclusive jurisdiction over all proceedings "arising under" the provisions of the Bankruptcy Code); *id.* § 157 (permitting the district court to refer all proceedings "arising under" the sections of the Code to the bankruptcy court).

powers pursuant to § 105 to preclude the enforcement of springing guaranties.[16]

Part I introduces the procedural and substantive issues that often arise in springing guaranty cases. Part II delves into an in-depth analysis of the appropriate jurisdiction to hear springing guaranty claims, and then proceeds to address the arguments in favor of and against the enforceability of springing guaranties. Part III first advocates for the bankruptcy court's jurisdiction over proceedings triggered by bankruptcy-related events, and then it urges the bankruptcy court's invocation of its equitable powers to deem springing guaranties unenforceable.

I. PROCEDURAL AND SUBSTANTIVE BACKGROUND

Part I of this Note begins by defining the bankruptcy court's subject matter jurisdiction for purposes of addressing the jurisdictional issue that often arises in springing guaranty cases. Then, it discusses what a springing guaranty is, the problems such a device entails, and the reasons behind its increasing prevalence in the past few years.

A. THE SUBJECT MATTER JURISDICTION OF THE BANKRUPTCY COURT

The bankruptcy court is a court of limited jurisdiction created by federal statute.[17] There are four possible paths through which the bankruptcy court may retain subject matter jurisdiction over a claim vis-à-vis the district court.[18] Pursuant to § 1334, original jurisdiction over all bankruptcy cases and proceedings vests in the district court.[19] Section 157 permits, but does not require, the district court to refer such "under," "arising under," "arising in," or "related to" bankruptcy cases

---

16. *See* 11 U.S.C. § 105(a) (giving the bankruptcy courts the power to enter necessary or appropriate orders to effectuate the provisions of the Code).

17. *See* 28 U.S.C. § 1334; *see also id.* § 157 (permitting, while not requiring the district court to refer cases "under" Title 11 or proceedings "arising under" or "arising in" Title 11, or "related to" a case under Title 11 to the bankruptcy court).

18. *See id.* § 1334(a) (providing the district courts with both original and exclusive jurisdiction over all cases *under* title 11); *see also id.* § 1334(b) (providing the district courts with "original but not exclusive jurisdiction of all civil proceedings *arising under* title 11, or *arising in* or *related to* cases under title 11") (emphasis added).

19. *Id.* § 1334(a), (b).

or proceedings to the bankruptcy court, which is now typically done as a matter of course.[20] Thus, assuming the district court refers such a proceeding to the bankruptcy court, the bankruptcy court can invoke one or more of its four statutory bases to hear that claim.[21] The former three (i.e. under, arising under, and arising in) constitute "core" proceedings, whereas the latter (i.e. related to) constitutes "non-core" proceedings.[22] The bankruptcy court has full adjudicative power over "core" proceedings, subject to appellate review.[23] In contrast, the bankruptcy court can merely propose findings of fact and conclusions of law in "non-core" proceedings, subject to *de novo* review.[24]

Section 157(b)(3) provides the bankruptcy court with the authority to decide whether a proceeding constitutes a "core" or "non-core" proceeding.[25] The Code provides a non-exhaustive list of proceedings that will per se implicate the bankruptcy court's "core" jurisdiction.[26] Examples from this list include: matters that affect the confirmation of the debtor's reorganization plan; matters that affect the administration of the bankruptcy estate; matters that concern the applicability of the automatic stay; matters that involve the allowance of claims or the discharge of debts; matters that implicate the property of the estate; and matters concerning the avoidance of fraudulent transfers, the validity of liens, and the use of cash collateral.[27] Where a claim is not included on

---

20. *Id.* § 157(a).

21. *Id.*; *see id.* § 1334(a) (providing the district courts with both original and exclusive jurisdiction over all cases *under* title 11); *see also id.* § 1334(b) (providing the district courts with "original but not exclusive jurisdiction of all civil proceedings *arising under* title 11, or *arising in* or *related to* cases under title 11") (emphasis added).

22. *See id.* § 157(b) (designating proceedings that arise under the Bankruptcy Code or arise in a bankruptcy case as "core" proceedings); *see also id.* § 157(c) (designating proceedings that are merely related to the underlying bankruptcy case as "non-core").

23. *Id.* § 157(b), (c) (dividing "core" proceedings from "non-core" proceedings by empowering bankruptcy courts to enter final orders or judgments after hearing "non-core" proceedings); *see also id.* § 158 (defining the types of review to be conducted on appeal).

24. *See id.* § 157(c); *id.* § 158.

25. *See id.* § 157(b)(3) (providing the bankruptcy judge with the authority to decide whether a proceeding is a "core" proceeding or a proceeding otherwise related to a bankruptcy case).

26. *Id.* § 157(b)(2).

27. *Id.*

the list, it may nonetheless be deemed "core" if it arises under Title 11 or if it could arise only in the context of a bankruptcy case.[28]

If the claim alleges a substantive right or cause of action that is a direct product of the Code, then that claim will be deemed to constitute a "core" proceeding "arising under" Title 11.[29] If the claim brought is the product of a state statute, then it does not arise under the Code.[30] If a defense to a cause of action set out in the complaint implicates the Code, then the claim does not confer "arising under" jurisdiction on the bankruptcy court.[31]

For the bankruptcy court to have "arising in" jurisdiction, the dispute would have to involve a claim that could only arise in the context of a bankruptcy case.[32] "'[A]dministrative matters' such as allowance and disallowance of claims, orders in respect to obtaining credit, determining the dischargeability of debts, discharges, confirmation of plans, orders permitting the assumption or rejection of contracts, are the principle constituents of 'arising in' jurisdiction."[33] A matter that arises in the context of a bankruptcy case cannot be "the subject of a lawsuit absent the filing of a bankruptcy case."[34]

If the proceeding is deemed to be "non-core," then the bankruptcy court cannot enter a final judgment or order.[35] However, the court may nonetheless retain "non-core" subject matter jurisdiction to hear the claim if the claim is "related to" a bankruptcy proceeding.[36] The test for

---

28. *In re* Exide Techs., 544 F.3d 196, 205-06 (3d Cir. 2008).

29. Stoe v. Flaherty, 436 F.3d 209, 217 (3d Cir. 2006).

30. *Id.* (holding that the Plaintiff's claim does not arise under the Bankruptcy Code because it is predicated on a Pennsylvania state statute, rather than on the Bankruptcy Code).

31. *Id.* (distinguishing Constitutional arising under federal question jurisdiction, which may be implicated by a federal defense to a state law claim from bankruptcy arising under jurisdiction, which may not be implicated by a federal defense to a state law claim).

32. *Id.* at 218.

33. *Id.* (citing COLLIER ON BANKRUPTCY § 3.01[4][c][iv] at 3–31).

34. *Id.* at 212-14 (explaining that mandatory abstention only applies in the context of "non-core" proceedings, as opposed to "core" proceedings).

35. *See* 28 U.S.C. § 157(c)(1) (2012) (limiting the bankruptcy judge to submitting proposed findings of fact and conclusions of law to the district court for the district court to enter the final order or judgment).

36. *Id.* ("A bankruptcy judge may hear a proceeding that is not a "core" proceeding but that is otherwise related to a case under title 11.").

determining whether a proceeding is related to the bankruptcy case is "whether the outcome of that proceeding could conceivably have any effect on the estate being administered in bankruptcy."[37] If the proceeding is deemed to be "related to" the bankruptcy case and a party to the proceeding already commenced a timely action in state court, the bankruptcy court must remand the proceeding to the state court under the doctrine of mandatory abstention.[38]

B. THE SPRINGING GUARANTY DEVICE AND THE PROBLEMS IT ENTAILS

The problem with the lender's use of a springing guaranty is the detrimental effect that such a device has on the debtor's prospects for a successful reorganization.[39] As one commentator notes, "[b]y imposing personal liability on a guarantor, which is usually a person in control of the borrower, bad boy guaranties create a financial disincentive for the guarantor to cause, or even permit, the borrower to impede the lender's collateral enforcement action by filing a bankruptcy petition."[40]

---

37. Pacor, Inc. v. Higgins, 743 F.2d 984, 994 (3d Cir. 1984) (emphasis omitted). Although of minimal relevance for purposes of this Note, it is nevertheless worthwhile to mention that the *Pacor* test only applies in the pre-confirmation context, and a different test applies to assess whether a post-confirmation proceeding is "related to" bankruptcy. *See* Stoe v. Flaherty, 436 F.3d 209, 216 n.3 (3d Cir. 2006).

38. 28 U.S.C. §1334(c)(2) (providing "[u]pon timely motion of a party in a proceeding based upon a State law claim or State law cause of action, related to a case under title 11 but not arising under title 11 or arising in a case under title 11, with respect to which an action could not have been commenced in a court of the United States absent jurisdiction under this section, the district court shall abstain from hearing such proceeding if an action is commenced, and can be timely adjudicated, in a State forum of appropriate jurisdiction").

39. *See Will Exploding Guaranties Bomb?*, *supra* note 4, at 134 (describing how a springing guaranty causes the guarantor to delay the borrower's filing and cost the borrower more money in the process); *see also* Thomas C. Homburger & James E. Goodrich, *Structuring Real Estate Loans: Leveraging Nonrecourse Carve-outs, Springing Guaranties, SPE Provisions and More,* STRAFFORD, 24 (July 10, 2014) [hereinafter *Structuring Real Estate Loans*] ("Springing recourse guaranties which are activated due to the borrower's insolvency can have the chilling effect of causing borrowers seeking to prevent the occurrence of a foreseeable payment default to wait until the last possible moment to alert servicers or lenders or seek modification of the loan, all in the hopes that it won't be necessary; this delay may exacerbate the insolvency problem when a default occurs.").

40. Eisenson, *supra* note 1, at 247.

As a result, the guarantor often refuses to authorize the filing of the petition at the time when the guarantor's fiduciary duties first obligate him to do so, thereby subjecting the guarantor to a lawsuit based on breach of fiduciary duty.[41] However, this latter consequence may be the preferred route for the guarantor after conducting a cost-benefit analysis between a multi-million dollar lawsuit based on breach of the springing guaranty and a lawsuit based on breach of fiduciary duty.[42] If the guarantor does consent to the bankruptcy filing, the initial delay as a result of the conflict of interest and ensuing disincentives imposed on the guarantor's decision-making process by the springing guaranty reduce the viability of the debtor upon filing and make it less likely the debtor will undergo a successful reorganization.[43] The problems created by the springing guaranty device are even further exacerbated where the loan contract does not limit the assets from which the creditor can collect, but rather permits the debt to be treated as full recourse against the guarantor.[44] This permits the creditor to collect from the guarantor the entire remaining deficiency between what the debtor owed the

---

41. *See Will Exploding Guaranties Bomb?*, *supra* note 4, at 132 (describing how the springing guaranty creates a conflict of interest between the guarantor's personal best interest and the guarantor's fiduciary duty to the borrower's creditors).

42. *See* David R. Kuney, "Springing Guaranties," *ALI CLE Commercial Real Estate Financing: Structuring and Documenting Transactions in a Reviving Market*, June 2014, ¶ *David Lichtenstein v. Willkie Farr* (discussing in Part III the debate over whether a guarantor owed a fiduciary duty to creditors to timely file for bankruptcy). *But see* Lichtenstein v. Willkie Farr & Gallagher LLP, 992 N.Y.2d 242, 246 (N.Y. App. Div. 2014) ("Had Lichtenstein failed to authorize or delayed ESI's bankruptcy filing, he would have been faced with uncapped personal liability on the basis of a breach of his duty to act in good faith.").

43. *See Will Exploding Guaranties Bomb?*, *supra* note 4, at 135 (discussing how springing guaranties prevent firms that would benefit from reorganization from filing for Chapter 11).

44. In one springing guaranty case, the guaranty agreement failed to cap the borrower's recovery from the guarantor at the value of the property. *See* Blue Hills Office Park LLC v. J.P. Morgan Chase Bank, 477 F. Supp. 2d 366, 388 (D. Mass. 2007). The value of the collateral underlying the loan was only $2 million, for which the borrower would be held responsible. *Id.* However, the District Court enforced the guaranty agreement according to its terms and permitted the lender to recover the entire $17.5 million deficiency. *See* David R. Kuney, *supra* note 42, ¶ Damages Not Limited to Actual Harm: Full Recourse VS. Actual Damages. Although *Blue Hills* did not involve a bankruptcy-related trigger, this type of analysis applies in all springing guaranty cases, regardless of the triggering condition. *Id.*

creditor pursuant to the loan and what the creditor obtains upon a sale of the debtor's assets underlying the loan.[45] This deficiency often amounts to millions of dollars, for which the guarantor can be—and frequently is—held personally liable.[46]

In order for the debtor to adhere to its obligations under its reorganization plan, the debtor often must look to insiders, like the guarantor, for loans.[47] It is not unusual for the debtor's plan to name the guarantor as a last-resort for financing.[48] For instance, in the bankruptcy case correlating to the *Kobernick* springing guaranty case, the plan of reorganization authorizes Communidad, the debtor therein, to borrow funds from the guarantor, Mitchell Kobernick, among other insiders, to the extent necessary for Communidad to fulfill its obligations to creditors pursuant to the plan and to pay its operating expenses in a timely manner.[49] The existence of the insider-guarantor, as a substitute

45. *See Blue Hills Office Park LLC*, 477 F. Supp. 2d at 388 (permitting the lender to collect the deficiency amount of $17.5 million minus the $2 million collateral value from the guarantor personally).

46. *See* Exhibit 3, column (c).

47. In determining whether to issue a § 105 injunction for the benefit of non-debtors, courts primarily focus on the monetary contributions of the guarantor to the debtor's reorganization. *See* Michael T. Madison, Jeffry R. Dwyer & Steven W. Bender, *Pursuit of the Guarantor Before Foreclosure of Realty Collateral—Effect of Mortgagor's Bankruptcy*, 2 LAW OF REAL ESTATE FINANCING § 15:13, 3 (August 2014) [hereinafter *Pursuit of the Guarantor*]. Madison, Dwyer & Bender advise lenders to try to limit the extent to which a guarantor can subsequently contribute assets to the debtor's reorganization in order to preclude a bankruptcy court from barring enforcement of the lender's claim against the guarantor. *Id.* It follows that these guaranties necessarily will undermine the debtor's reorganization prospects by preventing the debtor from looking to the guarantor for financial support in carrying out the provisions of the debtor's plan of reorganization. *Id.*; *see infra* notes 49-50, 466-67, 512-14 and accompanying text.

48. *See infra* notes 49, 469-70 and accompanying text.

49. *See* Debtor's First Plan of Reorganization, *In re* Communidad Kensington Club I, LLC, 08-BK-32127 (No. 46) (S.D. Tex. Jun. 27, 2008) ("The Reorganized Debtor shall be authorized to borrow funds from Mitchell Kobernick . . . to the extent necessary to pay operating expenses and to pay distributions to Creditors, including monthly payments on the Allowed Class 2 Claim."); *see also* Wells Fargo Bank Minnesota v. Kobernick, C.A. 8-CV-1458, 2009 WL 7808949 (S.D. Tex. May 28, 2009), *aff'd sub nom.*, U.S. Bank, Nat'l Ass'n v. Kobernick, 454 F. App'x 307 (5th Cir. 2011) (identifying Mitchell Kobernick as the guarantor liable pursuant to the springing guaranty).

source of financing to the debtor, reassures creditors, and consequently makes it more likely that each class of creditors will vote to confirm the debtor's reorganization plan.[50] However, where at the beginning of the debtor's bankruptcy case, the guarantor confronts a severe financial impediment (such as when a springing guaranty is enforced), it is improbable that the guarantor would permit the debtor's reorganization plan to cite his name as an alternative source of financing.[51] Thus, creditors are left with doubt about whether the debtor can uphold its obligations to creditors pursuant to the debtor's proposed plan.[52] This doubt makes it less likely that those classes of creditors will vote to confirm the debtor's plan.[53] As such, the bankruptcy court's

---

50. The advice Madison, Dwyer & Bender provide to lenders implicitly suggests that these types of guaranties reduce the debtor's likelihood of presenting a confirmable plan of reorganization. *See Pursuit of the Guarantor*, *supra* note 47, at 3 ("Guaranty agreements that restrict the guarantor's monetary or nonmonetary assistance to the debtor's reorganization are not likely to be enforced.").

51. *See supra* note 46 and accompanying text (illustrating the extent of liability springing guarantors face); *see also In re* Karta Corp., 342 B.R. 45, 54-57 (S.D.N.Y. 2006) (affirming the bankruptcy court's decision to enjoin the enforcement of non-debtor claims as a necessary prerequisite to the debtor's being able to fulfill the terms of its proposed plan).

52. In the case that set forth what is now "the most authoritative formulation of the [§ 105] test," the court relied heavily on the financial contributions of the non-debtor affiliates in issuing a permanent injunction for the benefit of those affiliates. *In re* Master Mortg. Inv. Fund, Inc., 168 B.R. 930, 938 (Bankr. W.D. Mo. 1994); *see also* Joshua M. Silverstein, *Hiding in Plain View: A Neglected Supreme Court Decision Resolves the Debate over Non-Debtor Releases in Chapter 11 Reorganizations*, 23 EMORY BANKR. DEV. J. 13, 64 (2006) (providing an in-depth discussion of the "Master Mortgage test"). In *Master Mortgage*, the debtor relied on an 80% funding contribution from non-debtor affiliates in order to reach a settlement with a creditor in the debtor's bankruptcy case. *Master Mortg.*, 168 B.R. at 932. Those non-debtor affiliates also had $3 million in claims against another creditor. *Id.* In order to successfully negotiate a settlement with that creditor, the debtor needed its affiliates to agree to release their claims against that creditor. *Id.* at 938. The affiliates did release their $3 million in claims, and the debtor reached a settlement with that creditor. *Id.* The implication to be drawn is that, without the cooperation of its non-debtor affiliates, the debtor could not have reached settlements with certain of its creditors. *Id.* Presumably, those creditors then would vote against plain confirmation, preventing the debtor from undergoing a successful reorganization. *Id.*

53. *See supra* notes 51-52 and accompanying text.

confirmation of the debtor's reorganization plan, the key indicator of a successful reorganization, becomes much less likely.[54]

II. THE CONFLICT OVER WHETHER TO ENFORCE SPRINGING GUARANTIES AND WHAT COURT SHOULD BE THE COURT TO ENFORCE THEM

Part II.A introduces the conflict among courts as to whether state courts, bankruptcy courts, or district courts are the appropriate jurisdiction to hear claims involving the triggering of springing guaranty recourse liability as a result of the borrower's filing for Chapter 11 bankruptcy protection. Part II.B copes with the scarcity of bankruptcy court opinions and analyzes the springing guaranty issue by drawing inferences from the bankruptcy court's response to similarly-situated debtors who have sought injunctive relief for the purpose of protecting their non-debtor affiliates. Part II.C introduces the substantive conflict of whether these springing guaranty provisions should be deemed enforceable, and if so, on what grounds.

A. THE JURISDICTIONAL CONFLICT

Preliminarily, it is important to note that no cases have yet arisen wherein the debtor explicitly cites § 362 of the Code in asking the bankruptcy court to enjoin enforcement of the springing guaranty action pursuant to § 105.[55] Although there has never been a springing guaranty case to cite explicitly to § 362 as the basis for the injunction request, there has been at least one springing guaranty case wherein the debtor

---

54. Rosemary E. Williams, *Confirmation of Plan of Reorganization by Business Entity Under Section 1129 of the Bankruptcy Code*, *in* 94 AM. JUR. PROOF OF FACTS 3D § 38 (2007) (citing *In re* Mangia Pizza Invs., LP, 480 B.R. 669 (Bankr. W.D. Tex. 2012)).

55. *See* 11 U.S.C. § 362(a) (2012) (providing for the automatic stay barring the post-filing assertion of any and all claims by lenders against the debtor); *see also Will Exploding Guaranties Bomb?*, *supra* note 4, at 135 (discussing the potential invocation of § 105 to enjoin enforcement against the springing guarantor by reference to the policies underlying the automatic stay); Michael T. Madison, Jeffry R. Dwyer & Steven W. Bender, *Exploding and Springing Guarantees*, 2 LAW OF REAL ESTATE FINANCING § 15:6 (August 2014) [hereinafter *Exploding and Springing Guarantees*] ("Thus far, the courts have not considered the application of § 105 injunctions to the springing or exploding guarantor.").

moves for a § 105 injunction in order to carry out the intent of the automatic stay.[56] There, the debtor explained that enforcement of the springing guaranty action against its guarantor would render its plan of reorganization unfeasible.[57] The debtor's plan required the guarantor "to contribute funds or pledge additional collateral as required to insure that all plan payments are timely made."[58] The debtor explained that its guarantor would be unable to uphold this commitment to fund the debtor's plan if the bankruptcy court failed to enjoin the enforcement of the springing guaranty.[59] However, the bankruptcy court denied the motion, thereby permitting the state court to retain jurisdiction over the springing guaranty issue.[60] Therefore, there has yet to be a case wherein a bankruptcy court *granted* an injunction barring enforcement of the springing guaranty in order to protect the bankruptcy proceeding.[61]

---

56. Debtor's Complaint for Injunction, *In re* Mkt. Ctr. E. Retail Prop., Inc., 1:09-BK-11696, at 3-4 (No. 69) (Bankr. D.N.M. 2009); *see also* Credit Alliance Corp. v. Williams, 851 F.2d 119, 121 (4th Cir. 1988) (analyzing debtor's motion for § 105 injunction based on the Congressional policies underlying the automatic stay). In *Williams*, the Court specifically cites the legislative history of § 362: "the automatic stay is one of the fundamental protections provided by the bankruptcy laws . . . . It permits the debtor to attempt a repayment or reorganization plan." *See Williams*, 851 F.2d at 121 (citing S. REP. No. 989, 95th Cong., 2d Sess. 54-55 (1978)). Thus, if the debtor's plan would be rendered unfeasible as a result of enforcement against the non-debtor guarantor, the legislative history of § 362 supports the issuance of an equitable injunction to bar enforcement of the springing guaranty. *Id.*

57. Debtor's Complaint for Injunction at 4 (Doc. No. 69), *In re* Mkt. Ctr. E. Retail Prop., Inc., 1:09-BK-11696.

58. *Id.* at 2.

59. *Id.* at 4.

60. "The [Bankruptcy] Court orally ruled at the preliminary hearing" that it would not force the lender seeking to enforce the springing guaranty in California State Court to litigate issues stemming from that guaranty litigation in this bankruptcy case. Memorandum Opinion & Order on Creditor's Supplemental Application for Allowance of Attorney Fees at 3, *In re* Mkt. Ctr. E. Retail Prop., Inc., 1:09-BK-11696 (No. 192) (442 B.R. 805, Bankr. D.N.M. Nov. 30, 2010) (denying, without opinion or elaboration, debtor's motion for § 105 injunction). "The [Bankruptcy] Court now makes that ruling in writing." *Id.* "[T]he California State Court is competent to decide what if any fees Mr. Lahave"—the springing guarantor—"ought to have to pay based on the guaranty." *Id.* "Whether Mr. Lahave then chooses to have Debtor reimburse him out of any surplus remaining after all of the claims against the estate are paid in full, is his decision." *Id.* at 4.

61. *See* 11 U.S.C. § 362 (2012) (protecting the debtor via the automatic stay of all post-filing litigation); *see also Will Exploding Guaranties Bomb?*, *supra* note 4, at 135

Even where a federal court—as opposed to a state court—has the opportunity to rule on the enforceability of a springing guaranty, it often declines to do so.[62] In *Post Investors LLC v. Gribble*, the district court granted the lender's motion to remand the case to state court.[63] The court held that regardless of whether the bankruptcy court had "related to" jurisdiction to hear the claim, mandatory abstention applied to require the court to remand the action.[64] Stanley W. Gribble, the guarantor, had argued that this springing guaranty proceeding was "related to" the borrower's pending bankruptcy case.[65] "This action," he asserted, "is related to the bankruptcy cases because, if found liable to Plaintiff herein, the Defendants will have an equitable subrogation claim against the Borrowers that could materially affect the Borrower's bankruptcy estates."[66] Gribble also argued that the proceeding could only "arise in" the context of the bankruptcy case, which constituted the default of the borrower, triggering the guarantor's liability under the loan agreement.[67] The district court noted that Gribble did not argue that the proceeding "arose under" the Code.[68] In making its ruling, the court did not fully address the guarantor's "related to" argument, but noted that given the unique circumstances of this bankruptcy case, it was unlikely there

(discussing the potential invocation of § 105 to enjoin enforcement against the springing guarantor by reference to the policies underlying the automatic stay); *Exploding and Springing Guarantees*, *supra* note 55 (commenting on how "the courts have not considered the application of § 105 injunctions to the springing or exploding guarantor"). *But see* Memorandum Opinion & Order on Creditor's Supplemental Application for Allowance of Attorney Fees at 3, *In re* Mkt. Ctr. E. Retail Prop., Inc., 1:09-BK-11696 (No. 192) (442 B.R. 805, Bankr. D.N.M. Nov. 30, 2010) (denying, without opinion or elaboration, the debtor's motion for § 105 injunction).

62. *See* Post Investors LLC v. Gribble, 12 CIV. 4479 ALC AJP, 2012 WL 4466619, at *4 (S.D.N.Y. Sept. 27, 2012) (holding that mandatory abstention applied and granting the plaintiff's motion to remand the springing guaranty proceeding to State Court); *see also In re* Extended Stay Inc., 418 B.R. 49 (Bankr. S.D.N.Y. 2009) (granting the plaintiff's motion to remand the proceeding to State Court based on the doctrine of mandatory abstention).

63. *Gribble*, 2012 WL 4466619, at *6.

64. *Id.* at *4.

65. *Id.* at *3.

66. *Id.* at *3; *see also* 11 U.S.C. § 509 (2012) (providing co-debtors with the ability to subrogate their claims as a means to gain leverage outside of the bankruptcy).

67. *Gribble*, 2012 WL 4466619, at *3.

68. *Id.* at *2.

could be any conceivable effect on the bankruptcy estate.[69] This was a unique case because the bankruptcy court had already dismissed the bankruptcy case unless the Borrowers paid the Plaintiff by the specified deadline.[70] Therefore, the district court noted that in light of the fact that nothing was actually happening in the Borrower's bankruptcy case since, for all intents and purposes, it had been dismissed, "this proceeding would exist outside of the bankruptcy case."[71]

In addition, the district court also agreed with both of the lender's arguments.[72] First, the lender argued that the guaranty agreement included a mandatory exclusive forum selection clause that was binding on the defendant.[73] The district court agreed with the lender's argument that the clause at issue gave it the exclusive right to choose whether to commence litigation in state or federal court, and since the lender chose state court, the case should be remanded.[74] Second, the lender argued that mandatory abstention required the court to remand the case to state court.[75] As previously mentioned, the district court agreed with the lender: mandatory abstention applied and warranted remand.[76]

Similarly, both the bankruptcy court and district court in the bankruptcy of Extended Stay Inc. debated the issue of whether the bankruptcy court had jurisdiction to rule on the enforceability of certain non-recourse carve-out guaranty agreements.[77] The bankruptcy court concluded that it did not have "related to" jurisdiction, and on that basis, granted the plaintiff's motion to remand.[78] However, on appeal, the district court disagreed with the bankruptcy court's decision on whether

---

69. *Id.* at *3 (distinguishing this case, which involved a liquidation of the debtor's property likely to generate sufficient proceeds to pay off the lender on the guaranty from a traditional reorganization, where the guarantor's equitable subrogation claims against the Borrowers would be more likely to effect the Borrower's bankruptcy estates).

70. *Id.* at *3.

71. *Id.* at *4.

72. *Id.* at *3.

73. *Id.* at *4.

74. *Id.*

75. *Id.*

76. *Id.*

77. *In re* Extended Stay Inc., 418 B.R. 49, 52 (Bankr. S.D.N.Y. 2009), *aff'd in part*, 435 B.R. 139 (S.D.N.Y. 2010).

78. *Id.* at 60.

it had "related to" jurisdiction over the springing guaranty proceeding.[79] Nevertheless, the district court ultimately agreed with the bankruptcy court, and remanded the case to the state court because of the mandatory abstention doctrine.[80]

The bankruptcy court made two findings essential to its conclusion on the "related to" issue.[81] First, the guaranty agreement included an express provision against indemnification, so holding the guarantor liable would not give rise to a claim that the guarantor would then be able to assert in the borrower's bankruptcy case.[82] Second, the guarantor mistakenly framed its jurisdictional argument on the basis of a public policy rationale that held little sway for the bankruptcy court in analyzing whether it had jurisdiction to hear the claim.[83] More specifically, the guarantor argued that the agreement was void as a matter of public policy because it in effect served as a bar on the debtor's ability to file for bankruptcy due to the perverse incentives it imposed on the debtor's key decision maker—the guarantor.[84] The guarantor also added that it created a conflict of interest that inhibited his ability to uphold the fiduciary duties he owed to creditors as the company approached insolvency.[85] The bankruptcy court found the public policy arguments unpersuasive: even if the springing nature of the guarantees disincentivized the guarantor from exercising rights granted under existing bankruptcy law, the bankruptcy "cases actually were filed," and "[the guarantor], as president, chief executive and chairman did, in fact, authorize such filings."[86]

On appeal, the district court acknowledged the errors made by the guarantor in arguing state law theories to support a bankruptcy court's

---

79. *In re* Extended Stay Inc., 435 B.R. 139, 150 (S.D.N.Y. 2010) ("The Bankruptcy Court did, however, err in its determination that it lacked 'related to' jurisdiction of [the lender's] claims because they could have no conceivable effect on Debtors' estates.").

80. *Id.* at 152.

81. *In re Extended Stay Inc.*, 418 B.R. at 58-59.

82. *Id.*

83. *Id.*

84. *Id.* at 57.

85. *Id.*

86. *Id.* at 59; *see also In re* Extended Stay Inc., 435 B.R. 139, 148 (S.D.N.Y. 2010) (referencing the bankruptcy court's rejection of the guarantor's public policy arguments on the ground that such arguments were "of 'minimal relevance' in light of the actual exercise of the Debtors' rights").

jurisdiction.[87] The district court predicated its "related to" analysis on provisions in the Intercreditor Agreement.[88] These provisions gave the lender the right to seek indemnification from the debtor for expenses incurred in litigating the springing guaranty issue.[89] They also provided for the adjustment of the rights of creditors in the debtor's bankruptcy case in the event that they received compensation outside of the bankruptcy case.[90] Thus, the district court held that the lender's potential indemnification claim coupled with the possible effect on distributions among creditors was sufficient to render the lender's springing guaranty proceeding "related to" the debtor's bankruptcy proceedings.[91] In so holding, the district court noted that since the estate's value would likely be too small to yield actual distributions, it was unlikely that the lender's recovery outside of the bankruptcy would affect those distributions.[92] Still, the mere possibility that the estate's value would be high enough to yield distributions justified the district court's finding of "related to" jurisdiction.[93] In the end, the district court remanded the case under a theory of mandatory abstention.[94]

Although some have read the bankruptcy court's initial opinion and parts of the district court's opinion to say that springing guaranty claims are not appropriate for the jurisdiction of the bankruptcy court, this Note takes the position that a correct reading of this case actually hinges on the manner in which the guarantor frames his jurisdictional arguments.[95] In this case, the guarantor sought to remove the action from state court to bankruptcy court.[96] However, in doing so, the guarantor failed to

87. *In re Extended Stay Inc.*, 435 B.R. at 150.
88. *Id.*
89. *Id.*
90. *Id.*
91. *Id.*
92. *Id.*
93. *Id.*
94. *Id.*
95. On appeal, the district court acknowledged these errors made by the guarantor in arguing state law theories to support a bankruptcy court's jurisdiction, but ended up remanding the case anyway under a theory of mandatory abstention. *Id.*; *see* David R. Kuney & Jeffrey E. Bjork; *2011 Emerging Issues 5615, The Springing Guaranty and Recourse Liability* 1, 3-4 (Apr. 28, 2011) (discussing the bankruptcy court's decision on its lack of jurisdiction in *In re* Extended Stay Inc., 418 B.R. 49, 57-59 (Bankr. S.D.N.Y. 2009)).
96. *In re* Extended Stay Inc., 418 B.R. 49, 52 (Bankr. S.D.N.Y. 2009).

address why enforcement of this guaranty would in practical terms impair the debtor's reorganization prospects.[97] It was necessary that the guarantor emphasize the bankruptcy court's ability to preclude such a detrimental effect on the debtor's reorganization prospects through the invocation of § 105 of the Code.[98] Section 105 provides bankruptcy courts with the power to issue a temporary injunction against enforcement of the springing guaranty in order to implement the provisions of the Code and the equitable policies those provisions represent in the context of a Chapter 11 proceeding.[99] In essence, the guarantor needed to explain that even if he would not have an indemnification claim to assert against the debtor's estate, he still had an argument based on the doctrine of equitable subordination, which would have an equally detrimental effect on the bankruptcy estate.[100]

Still, there are some cases where a federal district court, rather than a state court, rules on the enforceability of a springing guaranty triggered by a bankruptcy-related event.[101] It should be noted, however, that in all but three of these cases, the only reason a federal court ruled on the issue was that diversity existed between the two parties.[102] Usually, where diversity is the basis for a federal court's jurisdiction over the springing guaranty issue, the federal court does not provide a

---

97. In finding that it did not have "related to" jurisdiction over the springing guaranty proceeding, the bankruptcy court actually preserved the debtor's right to later argue that "the state court action . . . should be stayed under the Bankruptcy Code to the extent that the Debtors can demonstrate that [the guarantor] plays a critical role in the reorganization process and that prosecution of the litigation against him is interfering with or may threaten the success of the reorganization." *Id.* at 58-59.

98. *See* 11 U.S.C. § 105(a) (2012) (providing the bankruptcy court with the power to issue necessary or appropriate orders to carry out the provisions of the Bankruptcy Code).

99. *Id.*; *see Will Exploding Guaranties Bomb?*, *supra* note 4, at 135.

100. *See* 11 U.S.C. § 510(c) (providing for the doctrine of equitable subordination); *see also supra* notes 47-48 and accompanying text (explaining why it is highly likely guarantors will also hold claims as creditors in the debtor's bankruptcy case and thus be able to argue that the lender's claim should be equitably subordinated to their claim in the debtor's bankruptcy).

101. *See* Exhibit 3, column (b) (providing the case cite for any springing guaranty cases included in table 3 that were decided by a federal court).

102. *See* Exhibit 3, column (d) (identifying the springing guaranty cases that were decided by a federal court on the basis of diversity jurisdiction).

jurisdictional analysis.[103] Nevertheless, in *Kobernick*, the district court definitively concludes that the claim does not present a "core" issue.[104] As the court held, "[t]his is a basic contract dispute in which a creditor is trying to recover from guarantors under the terms of a loan agreement. Several bankruptcy courts have held that actions against third-party guarantors of the debtor's debts are not 'core' proceedings."[105] However, the district court left open the question of whether the bankruptcy court could have exercised "related to" jurisdiction over the claim: "[t]he parties dispute whether the instant action is sufficiently related to the Communidad Bankruptcy; however, this Court's diversity jurisdiction is uncontested."[106] Thus, the district court primarily relies on the diversity between the parties to retain the proceeding, but it also considers other factors, such as judicial economy.[107]

In an interesting decision, the Northern District of Texas predicated its subject matter jurisdiction over a springing guaranty proceeding on the "related to" jurisdiction of the bankruptcy court.[108] The district court concluded that the lender's foreclosure-triggered claim against the guarantor for the deficiency remaining under the loan was related to the borrower's breach of contract and fraud counterclaims filed in the bankruptcy court.[109] Pursuant to those counterclaims, the borrower sought to set aside the foreclosure as a fraudulent transfer pursuant to § 547.[110] The district court held that because the borrower's claims against the lender raised similar factual allegations, the outcomes in both proceedings could potentially affect the scope and administration of the

---

103. *Id*.

104. Wells Fargo Bank Minnesota v. Kobernick, C.A. 8-CV-1458, 2009 WL 7808949, at *1 (S.D. Tex. May 28, 2009).

105. *Id.* at *4.

106. *Id.*

107. *Id.* at *4-5. The other factors considered by the district court were: "the goals of promoting uniformity in bankruptcy administration, reducing forum shopping and confusion, fostering the economical use of the debtors' and creditors' resources, [] expediting the bankruptcy process, [and] . . . whether a jury demand had been filed by either side." *Id.* at *5.

108. LSREF2 Baron, LLC v. Aguilar, 3:12-CV-1242-M, 2013 WL 230381, at *2 (N.D. Tex. Jan. 18, 2013).

109. *Id.*

110. *Id.*; *see also* 11 U.S.C. § 547 (2012) (permitting the trustee, or the DIP in Chapter 11, to avoid fraudulent transfers in order to recover property of the estate).

borrower's bankruptcy estate.[111] Thus, federal jurisdiction over the springing guaranty proceeding was properly invoked pursuant to § 1334 because the springing guaranty proceeding "related to" the borrower's bankruptcy estate.[112] However, since the bankruptcy court for the Western District of Texas was already presiding over the debtor's bankruptcy case, the Northern District of Texas transferred the springing guaranty proceeding to the Western District of Texas as the more appropriate venue.[113] In doing so, the Northern District court left open the question of whether the Western District of Texas should refer that proceeding to its bankruptcy court.[114]

There are very few cases, where a bankruptcy court—as opposed to a district court—is the one actually ruling on the springing guaranty issue.[115] In most instances where the district court does refer the case to its bankruptcy court, it does so pursuant to the bankruptcy court's "non-core" "related to" jurisdiction, thereby enabling the district court to retain jurisdiction for purposes of entering the final judgment on the issue.[116]

In *In re South Side House, LLC*, the district court referred the proceeding to the bankruptcy court.[117] On October 12, 2011, the district court found that the bankruptcy court had "related to" jurisdiction over

---

111. *Aguilar*, 2013 WL 230381, at *2.

112. *Id.*; *see supra* note 14 and accompanying text.

113. *Aguilar*, 2013 WL 230381, at *8-9.

114. *Id.*

115. *See In re* Kingston Square Assocs., 214 B.R. 713, at *737-39 (Bankr. S.D.N.Y. 1997) (holding that because the guaranty agreement only provided for the voluntary filing of a bankruptcy petition to constitute a default, the involuntary filing does not constitute a default and therefore does not trigger the guarantor's liability).

116. *Aguilar*, 2013 WL 230381, at *8-9 (transferring the case to the Western District of Texas on venue grounds, while preserving the right of the Western District of Texas to refer the case to the Bankruptcy Court for the Western District – the court already presiding over the debtor's bankruptcy case); *see also In re* S. Side House, LLC, 470 B.R. 659, 665 (Bankr. E.D.N.Y. 2012) (referencing the district court's referral of the proceeding at issue to the bankruptcy court "for the issuance of proposed findings of fact and conclusions of law"); Sl Inv. US-Re Holdings 2009-1, Inc. v. Englett, No. 609-CV-281-ORL-28DAB, 2009 WL 1659164, at *1 (M.D. Fla. June 12, 2009) (referring the springing guaranty proceeding to the Bankruptcy Court on the grounds that the proceeding was, at a minimum, related to the debtor's bankruptcy case).

117. *In re S. Side House*, 470 B.R. at 665.

the springing guaranty issue.[118] Notably, at the time of this decision, the guarantors played key roles in the debtor's bankruptcy.[119] Menachem Stark and Israel Perlmutter, the two guarantors, were the debtor's sole equity owners and were the key personnel comprising the debtor in possession.[120] On January 3, 2014, Menachem Stark was murdered.[121] As a result, on January 15, 2014, the bankruptcy court held a hearing and subsequently issued an order appointing a trustee to take over the role of the debtors-in-possession.[122] Stark's murder did not occur until after the district court had decided that the bankruptcy court possessed "related to" jurisdiction over the springing guaranty proceeding.[123] If the district court decided that issue after the appointment of a trustee, it is uncertain whether the outcome would have been the same.[124]

---

118. *Id.* at 670.

119. *Id.* at 665.

120. *See* Debtor's Statement of Fin. Affairs at Question 21(b), *In re* S. Side House, LLC, No. 1-09-43576-ess (Bankr. E.D.N.Y. Apr. 30, 2009), ECF No. 24 (listing Menachem Stark and Israel Perlmutter as the sole officers and directors of the corporation, as well as the only stockholders to hold five percent or more of the voting or equity securities of the company).

121. *See* Anthony M. Destefano, *Trustee Will Oversee Company of Slain Brooklyn Landlord*, NEWSDAY (Jan. 16, 2014), http://www.newsday.com/news/new-york/trustee-will-oversee-company-of-slain-brooklyn-landlord-1.6816926 (reporting the abduction of Stark on the night of January 2 and the discovery of his partially burned corpse the following day).

122. *See id.* ("A trustee will handle the troubled real estate company of murdered Brooklyn landlord Menachem Stark . . . .").

123. *See In re S. Side House*, 470 B.R. at 670 ("On October 12, 2011, the District Court issued a decision and order referring the action to [the Bankruptcy] Court for proposed findings of fact and conclusions of law."); *see also* Destefano, *supra* note 121 (reporting the discovery of Stark's murdered body on January 3, 2014).

124. *See* 11 U.S.C. § 362 (2012) (providing for the debtor's automatic stay); *In re S. Side House*, 470 B.R. at 670. In *Extended Stay*, the bankruptcy court held that the guarantor made an insufficient showing as to the role he would play throughout the debtor's reorganization process, and thus, the springing guaranty proceeding was not "related to" the debtor's bankruptcy case. *See In re* Extended Stay Inc., 418 B.R. 49, 58-59 (Bankr. S.D.N.Y. 2009), *aff'd in part* 435 B.R. 139 (S.D.N.Y. 2010). In so holding, the court noted that its ruling should not be construed to preclude the debtor from subsequently filing a motion to modify the automatic stay. *Id.* If the debtor could show that its guarantor would play a particularly "critical role in the reorganization process and that prosecution of the litigation against him is interfering with or may threaten the success of the reorganization," the bankruptcy court hinted that it would be willing to modify the stay so as to encompass the non-debtor guarantor within its sphere

In *SL Investment US-Re Holdings 2009-1, Inc. v. Englett*, the district court analyzed the jurisdictional question in a unique manner.[125] The district court found that a springing guaranty proceeding is "at a minimum" "related to" a bankruptcy case because the amount that a lender collects from the guarantor will reduce the liabilities of the debtor's bankruptcy estate, and thusly, there is a conceivable effect on the bankruptcy estate.[126] Consequently, the district court referred the proceeding to the bankruptcy court based on the bankruptcy court at least having "related to" jurisdiction over the matter.[127] This holding further supports the argument that the two proceedings should be heard in tandem by the bankruptcy court.[128] This is because the bankruptcy

of protection. *See* 11 U.S.C. § 362 (providing for the debtor's automatic stay); *see also In re Extended Stay Inc.*, 418 B.R. at 58-59 (Bankr. S.D.N.Y. 2009), *aff'd in part*, 435 B.R. 139 (S.D.N.Y. 2010) ("The Court does not, by this ruling, limit the rights of the Debtors to later claim that the state court action brought by Bank of America should be stayed under the Bankruptcy Code to the extent that the Debtors can demonstrate that Lichtenstein, in particular, plays a critical role in the reorganization process and that prosecution of the litigation against him is interfering with or may threaten the success of the reorganization."). In *South Side*, the district court decided the jurisdictional question at a point in time when both guarantors were vital to the debtor's reorganization prospects. *In re S. Side House, LLC*, 470 B.R. at 670 (Bankr. E.D.N.Y. 2012) (noting that the district court referred the proceeding to the bankruptcy court on October 12, 2011—over two years prior to the death of one of the guarantors). After one of those two guarantors died and the other was replaced as the debtor in possession ("DIP") by a trustee, it is far less likely that any federal court would retain jurisdiction over a springing guaranty proceeding based on the potential for the litigation against the guarantor to threaten the success of the debtor's reorganization. *See* LSREF2 Baron, LLC v. Aguilar, 3:12-CV-1242-M, 2013 WL 230381, at *2 (N.D. Tex. Jan. 18, 2013) (citing the potential for the springing guaranty proceeding to affect the scope and administration of the borrower's bankruptcy estate as the key justification for its finding of "related to" jurisdiction); *In re S. Side House, LLC*, 470 B.R. at 670 (Bankr. E.D.N.Y. 2012) (relying on the district court's finding of "related to" jurisdiction in issuing proposed findings of fact and conclusions of law).

125. SL Inv. US-Re Holdings 2009-1, Inc. v. Englett, 609-CV-281-ORL-28DAB, 2009 WL 1659164, at *1 (M.D. Fla. June 12, 2009).

126. *Id.* at *1; *see also* Pacor, Inc. v. Higgins, 743 F.2d 984, 994 (3d Cir. 1984) (holding that a proceeding is related to the debtor's bankruptcy case if its outcome could conceivably effect the bankruptcy).

127. *See In re S. Side House*, 470 B.R. at 665.

128. *See* Martin E. Beeler, *Update on Jurisdiction: 2009*, 2010 NORTON ANN. SURV. OF BANKR. L. 36 (2010) (citing the guarantor's jurisdictional argument in *Extended*

court is the court best situated to reorganize the debt in a manner most likely to provide the debtor with an opportunity to successfully reorganize.[129] In addition, the holding suggests that the inverse nature of the two sources of liability for the lender could lead to a double recovery and a subsequent windfall for the lender if the two proceedings are not consolidated within the bankruptcy court.[130] If the lender recovers from the guarantor in state court and also recovers from the debtor in bankruptcy court for liability under the same loan document, there is no mechanism to ensure that the lender will not inadvertently benefit from a double recovery.[131]

At least one commentator believes that if the guarantor is held liable, the guarantor will always assume the place that the lender would have held as a creditor in the debtor's bankruptcy case.[132] That commentator argues that if the guarantor pays the lender on behalf of the borrower, then the guarantor automatically assumes the position the lender would have occupied in the borrower's bankruptcy.[133] This rationale supports the conclusion that the springing guaranty proceeding will always conceivably affect the debtor's bankruptcy estate, and thus, the bankruptcy court will always have "related to" jurisdiction to hear that claim.[134]

Stay); *see also In re Extended Stay Inc.*, 418 B.R. at 57 (discussing the potential for a springing guaranty proceeding to sufficiently relate to the debtor's reorganization).

129. The guarantor in *Extended Stay* argued that, "the state court action involves an attempt by Bank of America to circumvent its subordinate position in a complex capital structure by suing on a $100 million non-recourse carve-out guaranty." *See In re Extended Stay Inc.*, 418 B.R. at 57. Thus, at least in part, the guarantor predicated this jurisdictional argument on the "highly-structured transaction involving the debtors." *See* Beeler, *supra* note 128, at Part V.III. The implication is that in order to restructure the debt effectively the court would have to know the nature of that "highly-structured transaction involving the debtors." *Id.*

130. *See In re S. Side House*, 470 B.R. at 665.

131. *Id.*

132. *See* Eisenson, *supra* note 1, at 264 ("Once the guarantor pays the full debt amount, the lender will assign its rights to related claims against the borrower's estate in bankruptcy to the guarantor.").

133. *Id.*

134. *Id.*; *see also* S1 Inv. US-Re Holdings 2009-1, Inc. v. Englett, 609-CV-281-ORL-28DAB, 2009 WL 1659164, at *1 (M.D. Fla. June 12, 2009) ("Because any damages collected by SL Investment from [the guarantors] would reduce [the borrower's] liabilities, the Court finds that the instant suit is, at a minimum, a related proceeding that conceivably has an effect on the estate being administered.").

B. REFRAMING THE SUBSTANTIVE ISSUE TO RESOLVE THE JURISDICTIONAL BAR

This Subpart considers how guarantors and other third parties who are liable for the debtor's debts have traditionally sought to obtain protection for their non-debtor affiliates in the bankruptcy court.[135] This Subpart then seeks to transpose the tactics employed in such cases involving similarly-situated, non-debtor affiliates to the springing guaranty context.[136]

One way for the debtor to increase the likelihood of having the springing guaranty issue heard by the bankruptcy court is to move for an injunction to extend the protection afforded by the automatic stay to the

---

135. *See In re* Otero Mills, Inc., 25 B.R. 1018 (D.N.M. 1982) (justifying the issuance of a § 105 injunction based on the intent of the guarantors to help fund the reorganization); First Fed. Sav. & Loan Ass'n of Little Rock v. Pettit, 12 B.R. 147, 149 (E.D. Ark. 1981) (explaining that the close relationship between the debtor and the third party justified the issuance of a § 105 injunction since enforcement of the action against the third party "might place pressure on the bankrupt and ultimately affect the proposed reorganization."); *In re* Saxby's Coffee Worldwide, LLC, 440 B.R. 369, 379 (Bankr. E.D. Pa. 2009) (differentiating between when a permanent versus a temporary injunction is justified and when the non-debtor should be required to comply with certain conditions in exchange for the issuance of that injunction); *In re* Lyondell Chem. Co., 402 B.R. 571, 579-80 (Bankr. S.D.N.Y. 2009) (discussing the various ways in which a creditor's suit can affect the debtor's reorganization prospects); *In re* Steve's Furniture Warehouse, Inc., 46 B.R. 80, 82 (Bankr. S.D. Cal. 1985) (citing the subrogation of the guarantor's rights to those of the creditor "by operation of equity" as conferring upon the bankruptcy court at least "related to" jurisdiction over the non-debtor third party proceeding, where ultimately, the creditor or the guarantor will hold a claim against the estate, and thus, there will be an effect on the estate); *Pursuit of the Guarantor*, *supra* note 47, at 1 (discussing the bankruptcy court's potential invocation of § 105 to modify the automatic stay "to shield the solvent guarantor from the lender's collection efforts); *see also Exploding and Springing Guarantees*, *supra* note 55 (discussing the potential applicability of § 105 temporary and permanent injunctions to the springing or exploding guarantor).

136. *See* 11 U.S.C. § 362(a) (2012) (providing for the automatic stay barring the post-filing assertion of any and all claims by lenders against the debtor); *see also Will Exploding Guaranties Bomb?*, *supra* note 4, at 135 (discussing the potential invocation of § 105 to enjoin enforcement against the springing guarantor by reference to the policies underlying the automatic stay); *Exploding and Springing Guarantees*, *supra* note 55 ("Thus far, the courts have not considered the application of § 105 injunctions to the springing or exploding guarantor.").

debtor's non-debtor affiliates.[137] However, there have been very few bankruptcy cases that have addressed the issue where the lender includes a springing guaranty in the borrower's loan documents and the borrower subsequently triggers the guarantor's personal liability by filing for bankruptcy.[138] As such, the next best option is to consider how bankruptcy courts decide whether they can exercise jurisdiction over a § 105 proceeding brought in the debtor's bankruptcy case, wherein the debtor seeks the issuance of an injunction to protect a non-debtor third party.[139] It is preferable that the third party be an insider or affiliate of the debtor, so as to make the context more analogous to that of the springing guaranty context, where the guarantor is always an insider.[140]

---

137. *See* 11 U.S.C. § 105(a) (conferring upon the bankruptcy court the power to enter necessary or appropriate orders to effectuate the provisions of the Code); 11 U.S.C. § 362(a) (staying all post-filing attempts by lenders to collect from the debtor).

138. There is one springing guaranty case, where the bankruptcy court did rule on a § 105 Motion. *See* Debtor's Motion for Injunction, at 1, *In re* Mkt. Ctr. E. Retail Prop., Inc., 1:09-BK-11696-s11 (D.N.M. Aug. 30, 2009), ECF No. 63. However, aside from *In re* Market Center East Retail Property, there is a scarcity of case law specifically involving debtors filing § 105 Motions for the purpose of enjoining their primary secured lender from enforcing the springing guaranty. *See Exploding and Springing Guarantees*, *supra* note 55, at 2 ("[T]he courts have not considered the application of Section 105 injunctions to the springing or exploding guarantor.").

139. *See In re Otero Mills, Inc.*, 25 B.R. at 1020 (justifying the issuance of a § 105 injunction based on the intent of the guarantors to help fund the reorganization); *In re Lyondell Chem. Co.*, 402 B.R. at 582 (discussing the various ways in which a creditor's suit can effect the debtor's reorganization prospects); *Pettit*, 12 B.R. at 148 (explaining that the close relationship between the debtor and the third party justified the issuance of a § 105 injunction since enforcement of the action against the third party "could place pressure on debtor and ultimately affect proposed reorganization"); *In re Steve's Furniture Warehouse, Inc.*, 46 B.R. at 83 (citing the doctrine of equitable subrogation as conferring upon the bankruptcy court at least "related to" jurisdiction over the non-debtor third party proceeding, where ultimately, the creditor or the guarantor will hold a claim against the estate, and thus, there will be an effect on the estate); *In re Saxby's Coffee Worldwide, LLC*, 440 B.R. at 379 (differentiating between when a permanent versus a temporary injunction is justified and when the non-debtor should be required to comply with certain conditions in exchange for the issuance of that injunction).

140. *See In re* Linda Vista Cinemas, LLC, CV 10-786-TUC-CKJ, 2011 WL 1743312, at *5 (D. Ariz. May 6, 2011); *Pettit*, 12 B.R. 147, 147-49; *In re Saxby's Coffee Worldwide*, *LLC*, 440 B.R. at 379; *In re Lyondell Chem. Co.*, 402 B.R. at 587; *In re* Fowler Floor & Wall Covering Co., 93 B.R. 55, 58 (Bankr. M.D. Pa. 1988) (discussing the applicability of § 105 to enjoin proceedings brought by creditors against insider guarantors).

In deciding whether to issue a preliminary injunction to protect a non-debtor third party that does not have the benefit of the automatic stay, bankruptcy courts looks to four factors: "(1) whether there is a likelihood of successful reorganization; (2) whether there is an imminent irreparable harm to the estate in the absence of an injunction; (3) whether the balance of harms tips in favor of the moving party; and (4) whether the public interest weighs in favor of an injunction."[141] In *Lyondell*, the bankruptcy court analyzed the "likelihood of successful reorganization" factor by looking at the debtor's success up to that point in the bankruptcy.[142] The court measured success in terms of whether the debtor had thus far completed all of its obligations in the bankruptcy case.[143] Presumably, this takes into account whether the debtor had complied with all of its procedural obligations under the Bankruptcy Rules and the applicable local rules.[144] If there is nothing to indicate that it would be impossible for the debtor to eventually present a confirmable plan and if the debtor has met all of its obligations up to the point in the case when the court is deciding whether to issue the non-debtor injunction, then the debtor has satisfied the 'likelihood of successful reorganization' requirement.[145] Thus, the application of this first factor

141. *In re Lyondell Chem. Co.*, 402 B.R. at 588-89.

142. *Id.* at 587-90 (discussing the bankruptcy court's ability to enter "necessary or appropriate" orders where the consequence of not doing so would be a multitude of related proceedings occurring simultaneously in different forums).

143. *Id.* at 589-90 (finding that so long as the debtors have "been successful in doing everything they've needed to do to date" in their chapter 11 cases, that is sufficient to establish that their reorganization is likely to succeed.); *see also* 11 U.S.C. § 1107 (providing for the current management in Chapter 11 to act as the debtor-in-possession ("DIP"), thereby retaining control over the debtor's business operation throughout the entirety of the bankruptcy case). Bankruptcy obligations of the DIP presumably include continuing to manage the debtor's business and ensuring the timely filing of all schedules and other documents required by the bankruptcy court. *See* 11 U.S.C. § 704(a)(8) (requiring the trustee to furnish periodic reports and summaries of the business operations of the debtor with the bankruptcy court); *see also* the United States Trustee's Operating Guidelines and Reporting Requirements, at 1 n. 1, *available at* http://www.justice.gov/ust/r04/docs/general/dsc/ch11_guidelines.pdf ("11 U.S.C. § 704(a)(8) is made applicable to a chapter 11 debtor by 11 U.S.C. §§ 1106(a)(1) and 1107(a).").

144. *See* the United States Trustee's Operating Guidelines and Reporting Requirements, at 1 n. 1, *available at* http://www.justice.gov/ust/r04/docs/general/dsc/ch11_guidelines.pdf.

145. *In re Lyondell Chem. Co.*, 402 B.R. at 589.

seems to be more of a backwards-looking test than a forwards-looking test.[146] The second factor requires the debtor to prove either that it will suffer an irreparable injury if the action against its non-debtor affiliate goes forward or that enforcement of the non-debtor proceeding would impede its reorganization, but the debtor does not need to make a showing of both.[147] In balancing the harms to the debtor versus the creditor, the *Lyondell* court first considered whether enforcement of the guaranty would cause the related third-party entity or individual to file for bankruptcy itself.[148] The *Lyondell* court next considered whether the third party's absence would impair the debtor's business operations.[149] The court considered whether its enforcement of the guaranty would deter the third party from subsequently contributing DIP loans to the debtor's bankruptcy.[150] In measuring the harm to the creditor, the court focused on the injunction's temporary duration.[151] Finally, the public interest factor is about the impact of the bankruptcy court's equitable holding on the public's subsequent perceptions of the enforceability of guaranty agreements and the potential of having similarly situated creditors treated unfairly as a result of the holding.[152] With respect to the latter concern, it seems that in the context of springing guaranties, it would be appropriate to require the lender seeking to enforce the

146. *Id.* at 590 ("[T]he Debtors have so far been successful in doing everything they've needed to do to date. Whether they will be able to address later issues cannot be determined in the earliest weeks of a case . . . .").

147. *Id.* at 590-91.

148. *Id.* at 592.

149. *Id.* at 590-92 (explaining that enforcement against non-debtor affiliates would cause those affiliates to file for bankruptcy, resulting in a loss of going concern value, the benefits of integrated operations, and a default under the DIP financing facility).

150. *In re Lyondell Chem. Co.*, 402 B.R. at 592 (explaining how permitting the creditors to pursue the debtors' affiliates would lead to a default under the DIP financing facility).

151. *Id.* at 594 ("With the injunction lasting only 60 days, the interference with the 'sanctity' of guaranties will be minimized, and as importantly or more so, risks of disparate treatment of creditors will be minimized as well.").

152. *Id.* at 593-94 ("[T]he very purpose of guaranties is to protect the party that asked for the guaranty from the insolvency of the primary obligor, and that any regular practice permitting the enforcement of guaranties to be blocked or impaired when the primary obligor went into bankruptcy would frustrate the very purpose for which the guaranties were secured in the first place.").

guaranty to file its claim in the bankruptcy court.[153] Permitting the lender to file its springing guaranty claim elsewhere directly threatens the bankruptcy court's interest in preserving the public's expectation that all similarly situated creditors will be treated equally.[154] Therefore, on the basis of these four factors, it seems clear that the bankruptcy court can exercise jurisdiction over springing guaranty proceedings.[155]

Barring the enforcement of a springing guaranty leads to a greater probability of the debtor undergoing a successful reorganization and precludes the potential harm to the estate that would otherwise ensue from a delayed filing or the guarantor's subsequent unwillingness to provide DIP loans.[156] Despite the absence of case law specific to the springing guaranty context, the general analysis of bankruptcy courts that have considered whether to exercise jurisdiction over proceedings involving stay or injunction requests that preliminarily adhere to the benefit of a non-debtor guarantor and/or co-debtor is consistent.[157] If enforcement of the guaranty would hurt the debtor's reorganization, deplete estate assets, lead to decreased DIP financing, and/or impair the Chapter 11 debtor's continuing business operations, then the bankruptcy court has at least "related to" jurisdiction over the proceeding.[158]

---

153. *See* 11 U.S.C. § 361 (2012) (providing for the adequate protection of all creditors to the debtor's bankruptcy case); *see also In re* Saxby's Coffee Worldwide, LLC, 440 B.R. 369, 379 (Bankr. E.D. Pa. 2009) (justifying a partial injunction based on the extent of resources the insiders would have to direct towards litigation in non-bankruptcy courts at the expense of the debtor's reorganization).

154. *See* 11 U.S.C. § 361; *see also In re Saxby's Coffee Worldwide, LLC*, 440 B.R. at 379.

155. *In re Lyondell Chem. Co.*, 402 B.R. at 588-89 (providing in-depth discussion of the major factors bankruptcy courts consider in deciding whether to enjoin the enforcement of actions against non-debtor insiders).

156. *See* Exhibit 1, column (e); Exhibit 3, column (c); *infra* notes 468-70 and accompanying text.

157. *In re* Linda Vista Cinemas, LLC, CV 10-786-TUC-CKJ, 2011 WL 1743312, at *2-4 (D. Ariz. May 6, 2011); First Fed. Sav. & Loan Ass'n of Little Rock v. Pettit, 12 B.R. 147, 148 (E.D. Ark. 1981); *In re Saxby's Coffee Worldwide, LLC*, 440 B.R. at 379; *In re Lyondell Chem. Co.*, 402 B.R. at 588-89; *In re* Fowler Floor & Wall Covering Co., 93 B.R. 55, 58 (Bankr. M.D. Pa. 1988).

158. *In re Linda Vista Cinemas, LLC*, 2011 WL 1743312 at *2-4; *In re Lyondell Chem. Co.*, 402 B.R. at 588-89; *In re Saxby's Coffee Worldwide, LLC*, 440 B.R. at 379; *In re Fowler Floor & Wall Covering Co*, 93 B.R. at 58; *Pettit*, 12 B.R. at 148.

In an older case that addressed a bankruptcy remote provision contained in the corporate bylaws, as opposed to a strict springing guaranty, the guarantor created a clever solution that enabled him to file for bankruptcy and avoid liability under the guaranty entirely.[159] The lender required the debtor entities' corporate bylaws to contain a bankruptcy-remote provision.[160] Since this provision requires unanimous consent of all the directors before the debtors have the ability to authorize the filing of a voluntary petition, the lender's placement of an independent director on the debtors' board effectively barred a subsequent filing.[161] However, the lender failed to account for the possibility of an involuntary filing.[162] Thus, the debtors solicited others who had made loans to them to authorize an involuntary filing, thereby putting the debtors into bankruptcy on the basis of an involuntary petition.[163] As a result, the lender asked the bankruptcy court to dismiss the petition based on the fact that it was filed in bad faith, but the bankruptcy court declined.[164] The court held that even if the debtor indirectly utilized an unconventional means of filing for bankruptcy, the debtor's financial condition nevertheless indicated it belonged in bankruptcy.[165] This case presents an interesting hypothetical based on a similar scenario being transplanted into the springing guaranty context.[166] It demonstrates a creative way for the guarantor to try to circumvent being held personally liable pursuant to the guaranty.[167] Nonetheless, such a strategy would only be effective in cases where the

159. *In re* Kingston Square Assocs., 214 B.R. 713, 713-14 (Bankr. S.D.N.Y. 1997).

160. *Id.* at 716.

161. *Id.* at 714.

162. *Id.* at 716 (providing that the bankruptcy remote provision prevented the debtors from seeking voluntary bankruptcy protection).

163. *Id.* at 719.

164. *Id*. at 723.

165. Since the firm could benefit from the reorganization process, one prong of the two-prong test for collusion was not met, and thus, the court declined to dismiss the borrower's petition. *Id.* at 739; *see also id.* at 725 ("The standard in this Circuit is that a bankruptcy petition will be dismissed if both objective futility of the reorganization process and subjective bad faith in filing the petition are found.").

166. *Id.* at 723 (assuming the lender listed the borrower's voluntary bankruptcy filing as the only bankruptcy-related triggering condition under the loan agreement).

167. The guarantor could avoid liability under the guaranty agreement by soliciting creditors to put the borrower into bankruptcy involuntarily, so long as the borrower's finances reflected the need for the borrower to be in bankruptcy. *See id.* at 725.

guaranty agreement limited the bankruptcy-related triggering condition to voluntary filings, as opposed to also including involuntary filings as an event of default.[168] In effect, this tactic would, if successful, resolve the guaranty issue in its entirety and not just the jurisdictional sub-issue.[169]

C. THE SUBSTANTIVE CONFLICT OVER ENFORCEMENT OF THE SPRINGING GUARANTY

1. Arguments in Favor of Enforcement

Although not every jurisdiction has considered the issue of whether to enforce these springing guaranties or to deem them unenforceable for equitable, among other, reasons, the majority of those that have considered this issue have sided with the lender.[170] In addition, many of these courts permit the lender to collect from the guarantor, even where the loan contract provided for full recourse liability.[171] The rationale of these courts is predominantly grounded in contract law principles, namely the strict interpretation of the four corners of the contract.[172]

---

168. *Id.* at 723. *But see* Wells Fargo Bank v. Daniels, No. C-110209, 2011 WL 6677982, at *3 (Ohio Ct. App. Dec. 21, 2011) (suggesting that if the guaranty agreement does not explicitly limit the triggering condition to voluntary filings, as opposed to simply defining the trigger as any filings, courts will broadly interpret that language so as to encompass both voluntary and involuntary filings).

169. Assuming the loan agreement only defined voluntary filings as triggers to the guarantor's liability, the borrower's collusion with certain creditors to bring about an involuntary filing would not even constitute a default under the agreement. *See In re Kingston Square Assocs.*, 214 B.R. at 714-15 (permitting the guarantor to act in the borrower's best interest by putting the borrower into bankruptcy through the guarantor's organization of an involuntary filing, while also avoiding a voluntary filing, which would have subjected the guarantor to personal liability under the guaranty).

170. *See* Exhibit 3, column (c), (providing a table of springing guaranty cases and the holdings of those cases in column (c)).

171. *See generally* Exhibit 3 (providing a table of springing guaranty cases, the courts that decided those cases, and how those courts held).

172. *See Exploding and Springing Guarantees*, *supra* note 55 (presenting the contract law argument that a provision triggering the full recourse liability of the guarantor constitutes an unenforceable liquidated damages clause); *see also* Wells Fargo Bank Minnesota v. Kobernick, C.A. 8-CV-1458, 2009 WL 7808949, at *7 (S.D. Tex. May 28, 2009) (finding the Guarantors responsible for recourse liability "under the unambiguous terms of the contract"); First Nationwide Bank v. Brookhaven Realty

These courts enforce a contract according to its terms, even where its terms hold the guarantor liable for amounts far exceeding any damages directly resulting from the debtor's filing for bankruptcy.[173] Where the terms of a contractual agreement are clear on its face and the parties held equal bargaining positions in freely negotiating its terms, courts are unwilling to look to the parties' intent or other factors outside of the four corners of the loan agreement.[174] The problem is that contract law principles across the fifty states require courts to look first at the document's language, and if the language is clear, then courts are not permitted to proceed to a consideration of other factors outside the document itself.[175] Similarly, the law in almost every state permits a court to enforce a clear guaranty according to its terms, regardless of whether the guaranty is absolute or unconditional, and provides for the guarantor to waive all defenses he or she otherwise could have asserted to bar enforcement on the guaranty.[176] For the lender to make a prima facie case for breach of an absolute guaranty, the lender must provide that (1) the lender and guarantor did in fact sign and enter into an

---

Assocs., 637 N.Y.S.2d 418, 418 (N.Y. App. Div.) (holding that the parties were bound by the terms of their contract).

173. *See* Exhibit 3, column (c) (listing the holdings of springing guaranty cases, including the amounts for which the guarantor is held liable).

174. *Id.*

175. *See* U.S. Bank Nat'l Ass'n v. Cotta, No. 11-CV-410, 2012 WL 5335999, at *4 (S.D. Tex. Oct. 26, 2012) (strictly applying the elements of a breach of contract claim to the facts of the case); Nat'l Ass'n v. Singh, No. CIV.A. H-12-0147, 2012 WL 3186036, at *3 (S.D. Tex. Aug. 2, 2012) (strictly applying the terms of the guaranty agreement to the facts of the case to establish the guarantor's liability thereunder).

176. *See In re* S. Side House, LLC, 470 B.R. 659, 677 (Bankr. E.D.N.Y. 2012) (citations omitted); LBCMT 2007-C3 Sterling Retail, LLC v. Sheppard, 1:12-CV-470, 2013 WL 2151683, at *2-3 (E.D. Va. May 15, 2013); LBCMT 2007-C3 Seminole Trail, LLC v. Sheppard, 3:12CV00025, 2013 WL 3009319, at *3 (W.D. Va. June 17, 2013); *see also* Prestige Capital Corp. v. Michigan Gage & Mfg., LLC, 722 F. Supp. 2d 837 (E.D. Mich. 2010) (analyzing the standard for establishing a *breach of guaranty* action under New Jersey law pursuant to a choice of law provision in the guaranty agreement). Three bankruptcy-triggered Sixth Circuit cases likewise strictly construe the guaranty agreements therein according to their terms. 8375 Honeytree Blvd. Holdings, LLC v. Starman, 11-12431, 2012 WL 683379, at *2-3 (E.D. Mich. Mar. 2, 2012); 111 Debt Acquisition LLC v. Six Ventures, Ltd., C2-08-768, 2009 WL 414181, at *3 (S.D. Ohio Feb. 18, 2009), *aff'd sub nom.*, 111 Debt Acquisition Holdings, LLC v. Six Ventures Ltd., 413 F. App'x 824 (6th Cir. 2011); Wells Fargo Bank v. Daniels, No. C-110209, 2011 WL 6677982, at *3 (Ohio Ct. App. Dec. 21, 2011).

absolute guaranty, (2) there is still outstanding and overdue debt under that guaranty, (3) the borrower defaulted on its primary obligation to the lender, and (4) the guarantor has failed to fulfill his or her duty to pay that debt.[177]

In *JPMCC 2007-C1 Grasslawn Lodging, LLC v. Dix*, the court held that since the springing guaranty was a guaranty of payment, it was appropriate for the lender to sue the guarantor at any point after the default without reference to when and/or whether the guarantor also sought payment from the borrower.[178] The *Dix* court explained:

> the Guaranty expressly provides that it is a guaranty of payment as opposed to a guaranty of collection. Pursuant to New York law, a guaranty of collection only binds the guarantor to pay if all attempts to obtain payment from the debtor have failed, however, a guaranty of payment binds the guarantor to pay immediately upon default of the debtor. Accordingly, since the Borrowers defaulted when they filed for bankruptcy and Defendant endorsed a guaranty of payment, the Plaintiff need not attempt to obtain payment or wait to receive payment from the Borrowers, prior to collecting from the guarantor.[179]

Thus, the court concluded that the lender could enforce the guaranty against the guarantor.[180]

The *Dix* approach makes sense based on the explicit terms of the loan document and guaranty, but practically speaking, this is not a debtor that has defaulted.[181] As the term "default" is commonly understood, a borrower defaults when that borrower fails to fully pay a loan.[182] Here, the borrower is the debtor, and the plaintiff is the lender

---

177. *See Sheppard*, 2013 WL 2151683, at *2.

178. JPMCC 2007-C1 Grasslawn Lodging, LLC v. Dix, CV-11-00017-TUC-CKJ, 2013 WL 1340039, at *7 (D. Ariz. Apr. 1, 2013).

179. *Id.* at *7.

180. *Id.* at *9.

181. *Id.*; *see also* James Schwarz & Linda A. Striefsky, *Nuts and Bolts of Negotiating Nonrecourse Carveouts*, COMMERCIAL REAL ESTATE FINANCING: STRUCTURING AND DOCUMENTING TRANSACTIONS IN A REVIVING MARKET 129, 131 (June 2014).

182. *See* Schwarz & Striefsky, *supra* note 181, at 131 (explaining the general concept of default in terms of the rationale behind the making of the loan in the first place by stating that "whether a loan is secured or not, the lender expects that the borrower will repay the loan in full; otherwise, the loan would not be made").

seeking to enforce the guaranty.[183] In addition, as of the date the guaranty issue was decided, the bankruptcy court had confirmed the debtor's plan of reorganization that provided for the lender's claims to be paid in full.[184] Therefore, even if a guaranty of payment requires the guarantor to pay immediately upon the borrower's default, it is nonetheless inaccurate to automatically define the borrower's "default" as the borrower's filing for bankruptcy.[185] Even if the four corners of the loan document defined default as the borrower's filing for bankruptcy, the borrowers were obligated to make payments until the entire debt was paid off pursuant to their confirmed plan since they had commenced making payments to the lender.[186] This does not constitute a default in practice.[187] The distinction between a guaranty of payment and a guaranty of collection is one that should be drawn by considering whether there was in fact a default, rather than by looking at whether the predefined definition of a default has been satisfied.[188]

---

183. *Dix*, 2013 WL 1340039, at *3.

184. *Id.*

185. Where the debtor continues to pay off its debt to the lender in incremental payments, it seems nonsensical to deem such a borrower to be in default. *See id.* ("[P]ursuant to the Borrower's plan which was confirmed on December 30, 2011 by the Bankruptcy Court, the Plaintiff's claim will be paid in full by the Borrowers."); *see also* Schwartz & Striefsky, *supra* note 181 (explaining the general concept of default in terms of the rationale behind the making of the loan in the first place by stating that "whether a loan is secured or not, the lender expects that the borrower will repay the loan in full; otherwise, the loan would not be made"). This implies that if the borrower intends to and plans on repaying the loan in full, the borrower has not defaulted on the loan. *See id.* The Michigan legislature explained its intent behind precluding personal liability arising from carveouts to nonrecourse loans as follows: "[t]he legislature recognizes that it is inherent in a nonrecourse loan that the lender takes the risk of a borrower's insolvency, inability to pay, or lack of adequate capital after the loan is made and that the parties do not intend that the borrower is personally liable for payment of a nonrecourse loan if the borrower is insolvent, unable to pay, or lacks adequate capital after the loan is made." *See* Nonrecourse Mortgage Loan Act, 2012 Mich. Legis. Serv. P.A. 67, ¶ N.M.L.A. § 445.1591 Note (S.B. 992).

186. *Dix*, 2013 WL 1340039, at *2-3.

187. *See* Schwarz & Striefsky, *supra* note 181, at 131.

188. *See Dix*, 2013 WL 1340039, at *3, *7. The *Dix* Court deemed the Borrowers to have "defaulted" on the basis of Section 8.1(a) of the Loan Agreement, which included the filing of a bankruptcy petition as an event constituting default. *Id.* at *3, *7 (explaining that, "[under] New York law, a guaranty of collection only binds the guarantor to pay if all attempts to obtain payment from the debtor have failed, however,

Thus far, the courts that have considered whether a springing guaranty constitutes an unenforceable *ipso facto* clause hold that springing guaranty provisions do not violate § 365(e) of the Code.[189] Unlike an absolute waiver of the protections afforded to a debtor under the Code, springing guaranty provisions in loan documents do not "prohibit [the debtor] from resorting to bankruptcy; [they] merely provide that if [the debtor] took certain actions it would forfeit its exemption from liability for any deficiency."[190] In holding that there is no violation of § 365(e), some courts argue that a loan agreement is neither an executory contract nor an unexpired lease, and thus, § 365(e) simply does not apply.[191] In so holding, these courts explain that the loan agreement is not an executory contract because an executory contract requires some degree of performance pursuant to the agreement's terms on the part of both the debtor and the guarantor.[192] Thus, these courts conclude that the loan agreement cannot be an executory contract because the lender already fulfilled the obligations it had pursuant to the agreement by providing the debtor with the requested funds.[193] Other courts hold that § 365(e) is inapplicable because it only extends to the debtor, not the debtor's guarantor.[194]

---

a guaranty of payment binds the guarantor to pay immediately upon default of the debtor. Accordingly, since the Borrowers defaulted when they filed for bankruptcy and Defendant endorsed a guaranty of payment, the Plaintiff need not attempt to obtain payment or wait to receive payment from the Borrowers, prior to collecting from the guarantor").

189. First Nationwide Bank v. Brookhaven Realty Assocs., 637 N.Y.S.2d 418, 421 (N.Y. App. Div. 1996); Monroe Ctr. II Urban Renewal Co. v. Strategic Performance Fund-II, No. C-52-08, 2010 WL 5343317, at *3 (N.J. Super. Ct. App. Div. Dec. 29, 2010); *Dix*, 2013 WL 1340039, at *6-7; *see also* 11 U.S.C. § 365(e)(1)(A) (2012) (permitting the termination or modification of executory contracts or unexpired leases conditioned on the insolvency of the debtor).

190. FDIC v. Prince George Corp., 58 F.3d 1041, 1046 (4th Cir. 1995).

191. *Dix*, 2013 WL 1340039, at *6-7; *see also First Nationwide Bank*, 637 N.Y.S.2d at 421 (excluding a mortgage from the definition of an executory contract).

192. *See First Nationwide Bank*, 637 N.Y.S.2d at 421.

193. *Dix*, 2013 WL 1340039, at *6 (citing N.L.R.B v. Bildisco & Bildisco, 465 U.S. 513, 522 n. 6 (1984)).

194. *Monroe Ctr. II Urban Renewal Co.*, 2010 WL 5343317, at *3.

2. Arguments Against Enforcement

Ironically, commentators often cite the recently enacted legislation in Michigan and Ohio, the Nonrecourse Mortgage Loan Act ("NMLA") and the Legacy Trust Act ("LTA"), respectively, as a potential challenge for lenders.[195] The NMLA and LTA invalidate carve-out provisions contained in nonrecourse loan documents that seek to hold the guarantor liable for the full value of the loan upon the borrower's default.[196] Although at first glance, the NMLA and LTA appear to invalidate all springing guaranties, they both carve out an exception for a "[p]ost closing solvency covenant:" "a covenant not to file a voluntary bankruptcy or other voluntary insolvency proceeding or not to collude in an involuntary proceeding."[197] Since the primary prohibition in the NMLA and the LTA only applies to nonrecourse carve-outs found in "[a] post closing solvency covenant," the Michigan and Ohio legislation effectively invalidate all springing guaranties other than those triggered by the borrower's filing of a bankruptcy petition.[198]

One of the strongest arguments against the enforcement of these springing guaranties is grounded in corporate law principles.[199] A springing guaranty creates a conflict of interest for the guarantor once

---

195. *See* Beslow & Eliason, *supra* note 4, at *5; *Exploding and Springing Guarantees*, *supra* note 55, at 3; Fluhrer et al., *supra* note 7, at 2 (explaining that the NMLA applies to all nonrecourse loans on the basis of the Michigan legislature's belief that solvency covenants in nonrecourse loans were against public policy and therefore invalid and unenforceable); *see also* The Legacy Trust Act ("LTA"), OHIO REV. CODE ANN. §§ 1319.07-.09 (West 2013); Michigan's Nonrecourse Mortgage Loan Act ("NMLA"), 2012 Mich. Pub.Act 67, MICH. COMP. LAWS § 445.1591 *et seq.*

196. *See* The Legacy Trust Act ("LTA"), OHIO REV. CODE ANN. §§ 1319.07-.09 (West 2013); Michigan's Nonrecourse Mortgage Loan Act ("NMLA"), 2012 Mich. Pub.Act 67, MICH. COMP. LAWS § 445.1591 *et seq.*

197. NMLA, MICH. COMP. LAWS § 445.1592(2)(d); *see also* LTA, OHIO REV. CODE ANN. § 1319.07(D).

198. *See* NMLA, MICH. COMP. LAWS § 445.1592(2)(d); LTA, OHIO REV. CODE ANN. § 1319.07(D).

199. *See* Eisenson*, supra* note 1, at 264 (describing the conundrum faced by the insider subject to a springing guaranty should the firm become insolvent); *see also Will Exploding Guaranties Bomb?*, *supra* note 4, at 132 ("Perhaps the most obvious argument against springing and exploding guaranties . . . is that they are intended to create a conflict between the guarantor's self-interest and the fiduciary duties owed to all of the borrower's creditors as the borrower becomes insolvent.").

the borrower becomes insolvent.[200] At that point, the guarantor is forced to choose between filing for bankruptcy, thereby triggering his or her own personal liability pursuant to the guaranty, or not filing for bankruptcy, thereby breaching his or her fiduciary duties and subjecting himself or herself to a potential lawsuit.[201] For the guarantor to avoid breaching his or her fiduciary duties, the guarantor would have to abstain from voting on the decision whether to file.[202] However, by abstaining, the guarantor is also in effect acquiescing in the borrower's filing and subjecting himself or herself to personal liability.[203] If the guarantor abstains from voting and the borrower then votes to file, the guarantor will still be held personally liable under the broad terms of the guaranty regardless of his or her abstention.[204] Alternatively, if the guarantor is the borrower's only insider with the power to authorize the bankruptcy filing, then the guarantor must file as soon as the borrower's balance sheet indicates that it is in the best interest of the company to enter bankruptcy.[205] The guarantor's failure to behave in this manner constitutes a breach of his or her fiduciary duties.[206] As a result of the enormous liability threatened by the guaranty, the guarantor will be reluctant to authorize the borrower's filing of a bankruptcy petition and instead will be induced to take drastic and risky measures to try to save

200. If the insider votes on whether to file, that insider may be held liable for breach of fiduciary duty. Eisenson, *supra* note 1, at 265. On the other hand, if the insider declines to vote, but the firm votes to file anyway, the insider may still be held personally liable pursuant to the guaranty. *Id.*

201. *Id.* at 264-65.

202. *Id.*

203. *Id.*

204. *Id.*

205. *See Will Exploding Guaranties Bomb?*, *supra* note 4, at 133 (discussing the need for one or more disinterested parties to approve or ratify the conflicted director's decision on whether or not to file for bankruptcy); *see also* Lichtenstein v. Willkie Farr & Gallagher LLP, 992 N.Y.S.2d 242, 246 (N.Y. App. Div. Sept. 18, 2014) (illustrating the exacerbation of the conflict imposed on the guarantor who is also the Board Chairman and thus main decision maker of the borrower).

206. *Lichtenstein*, 992 N.Y.S.2d at 246 (noting that, were the guarantor to refuse to authorize, or at least delay, a bankruptcy filing, the guarantor would risk liability for breach of fiduciary duty).

the company and avoid ever having to file.[207] Consequently, the springing guaranty creates a disincentive to filing, while simultaneously inducing the guarantor to breach his or her fiduciary duties.[208] Because it is a tort for a guarantor to breach his or her fiduciary duties, a springing guaranty is void as a matter of public policy.[209] In the alternative, a springing guaranty is void as a matter of bankruptcy policy because the guarantor's decision to delay the filing ultimately causes the borrower to lose his or her shot at a meaningful reorganization.[210]

In deciding whether to enforce a springing guaranty, some courts have embraced the contract law distinction between a reasonable damages calculation and an unenforceable penalty.[211] A court will find

---

207. *See infra* notes 483-501 (providing examples of how the springing guaranty device leads to the pre-filing depletion of the debtor's assets); *see also* Exhibit 3, column (c) (illustrating the scope of liability springing guarantors face).

208. *See* Eisenson, *supra* note 1, at 264 (explaining that whether or not such a provision should be invalidated depends on whether it is viewed from an *ex ante* or an *ex post* perspective); *Will Exploding Guaranties Bomb?*, *supra* note 4, at 132.

209. *See Lichtenstein*, 992 N.Y.S.2d at 246 (noting that, were the guarantor to refuse to authorize, or at least delay, a bankruptcy filing, the guarantor would risk liability for breach of fiduciary duty).

210. As the guarantor tries desperately to save the company, the company's financial condition continues to deteriorate past the point of viability for reorganization prospects. If the insider does finally authorize the filing but at a point that is too late, the company is already in such bad shape that it no longer makes sense to try to rehabilitate it. *See* First Nationwide Bank v. Brookhaven Realty Assocs., 637 N.Y.S.2d 418 (N.Y. App. Div. 1996) (explaining that its decision to enforce the springing guaranty would not undermine any Bankruptcy Code policies because the bankruptcy case had already been dismissed and the only major creditor was the lender seeking to enforce the guaranty). If, on the other hand, the springing guaranty issue is being heard at a time where the debtor's reorganization prospects are largely irrelevant—for instance, if the bankruptcy case had already been dismissed—the persuasiveness of this bankruptcy policy argument will be considerably undermined. *Id.*

211. *See* Bank of Am. v. Lahave, No. B237360, 2013 WL 1208423 (Cal. Ct. App. Mar. 26, 2013) (declining to enforce a penalty that went "beyond compensation into punishment"); ING Real Estate Fin. LLC v. Park Ave. Hotel Acquisition LLC, 907 N.Y.S.2d 437 (N.Y. Sup. Ct. 2010) (thoroughly analyzing the guarantor's penalty argument, albeit in the context of a different triggering condition other than the borrower's bankruptcy filing). *But see* UBS Commercial Mort. Trust 2007-FL1 v. Garrison Special Opportunities Fund L.P., 2011 N.Y. Slip Op. 51774(U) (N.Y. Sup. Ct. Mar. 8, 2011) (analyzing the guarantor's argument that the guaranty called for an unenforceable penalty, but ultimately rejecting that argument and enforcing the guaranty).

an unenforceable penalty where the full recourse damages specified under the guaranty are "grossly disproportionate to the probable loss" of the lender.[212] Since the recourse damages called for under the guaranty far exceed the actual damages suffered by the lender as a result of the borrower's bankruptcy filing, the penalty is unenforceable.[213] It is the borrower's bankruptcy filing that constitutes a breach under the terms of the loan and guaranty agreements, which therefore subjects the guarantor to recourse liability.[214]

3. Synthesis of the Existing Case Law and Legislation

a. The Circuits

As a preliminary matter, the scope of this section is limited to bankruptcy-related springing guaranty cases.[215] A thorough investigation of those cases reveals that the decision of whether or not to enforce a bankruptcy-triggered springing guaranty is an issue of first impression in many circuits.[216] Courts located within the First, Seventh, Eighth,

---

212. *ING Real Estate Fin. LLC*, 907 N.Y.S.2d at *5; *see also Lahave*, 2013 WL 1208423, at *1.

213. *See UBS Commercial Mortg. Trust 2007-FL1*, No. 652412, slip op. at 4-5.

214. *Id.*

215. This means that the cases surveyed are only those where the triggering condition is either a bankruptcy filing or a collateral consequence of that filing. An example of such a collateral consequence would be the collateral securing the loan and becoming an asset in the bankruptcy proceeding. Second, the cases presented are from the relatively recent past with a few exceptions: where this section references the "existing case law," it is referencing the state of the law as of today's date. Thus, although a few older cases are cited, the intent here is not to provide a historical overview of the governing case law at different points in time, but rather is limited to the case law in the circuits as it exists today.

216. *See* Brian E. Greer, Joel S. Moss & Nicole B. Herther-Spiro, *Guaranties in Bankruptcy: A Primer II*, 2014 ANN. SURV. OF BANKR. L. 7 (2004) [hereinafter *Guaranties in Bankruptcy*] ("Until the most recent downturn in the real estate market, the enforceability of such guaranties had generally not been tested in the courts."). Part VIII surveys post-2008 springing guaranty cases that have arisen. *Id.* In passing, Part VIII mentions cases decided in California, Georgia, Illinois, Massachusetts, Michigan, and New Jersey. *Id.* at n. 244. It does not include a discussion of any cases arising in states within the Fourth, Fifth, Eighth, and Tenth circuits. *Id.* Of those bad boy guaranty cases from the First, Third, Sixth, Seventh, Ninth, and Eleventh Circuits, none involved a bankruptcy-related event as the triggering condition. *Id.* (citing Wells Fargo Bank,

Tenth, and Eleventh Circuits have no case law that directly involves a springing guaranty triggered by the borrower's bankruptcy filing or a collateral consequence of that filing.[217] Although the Eighth Circuit has not yet addressed the enforceability of springing guaranties, its broad approach to the jurisdiction of the bankruptcy court could bode well for purposes of the jurisdictional issue.[218]

In the Third Circuit, there are also very few cases directly on-point.[219] However, there is at least one case where the court found a

---

N.A. v. Mitchell's Park, LLC, 2012 WL 4899888 (N.D. Ga. 2012); 51382 Gratiot Ave. Holdings, LLC v. Chesterfield Dev. Co., 835 F. Supp. 2d 384 (E.D. Mich. 2011); Blue Hills Office Park LLC v. J.P. Morgan Chase Bank, 477 F. Supp. 2d 366 (D. Mass. 2007); Heller Fin., Inc. v. Lee, 2002 WL 1888591 (N.D. Ill. 2002); Bank of Am. v. Freed, 983 N.E.2d 509, 521 (Ill. App. Ct. 2012); GECCMC 2005-C1 Plummer Street Office Ltd. v. NRFC NNN Holdings, LLC, 140 Cal. Rptr. 3d 251 (Cal. Ct. App. 2012); Wells Fargo Bank, NA v. Cherryland Mall Ltd., 812 N.W.2d 799 (Mich. Ct. App. 2011); CSFB 2001-CP-4 Princeton Park Corp. Ctr., LLC v. SB Rental I, LLC, 980 A.2d 1 (N.J. Super. Ct. App. Div. 2009)). This implies that specifically on-point case law from courts located within those circuits has yet to arise. *Id.* However, this comprehensive annual survey overlooks certain springing guaranty cases decided by courts located within the geographical boundaries of the Third, Sixth and Ninth Circuits that have involved bankruptcy-triggered bad boy guaranties. *Id. But see JPMCC 2007-C1 Grasslawn Lodging*, 2013 WL 1340039; 8375 Honeytree Blvd. Holdings, LLC v. Starman, No. 11-12431, 2012 WL 683379 (E.D. Mich. Mar. 2, 2012); 111 Debt Acquisition LLC v. Six Ventures, Ltd., No. C2-08-768, 2009 WL 414181 (S.D. Ohio Feb. 18, 2009), *aff'd sub nom.*, 111 Debt Acquisition Holdings, LLC v. Six Ventures Ltd., 413 F. App'x 824 (6th Cir. 2011); Wells Fargo Bank, N.A. v. Daniels, Nos. C-110209, C-110215, 2001 WL 6677982 (Ohio Ct. App. Dec. 21, 2011); *Lahave*, B237360, 2013 WL 1208423; Monroe Ctr. II Urban Renewal Co. v. Strategic Performance Fund-II, Inc., *aff'd by* 2010 WL 5343317 (N.J. Super. Ct. App. Div. Dec. 29, 2010). *See also Will Exploding Guaranties Bomb?*, *supra* note 4, at 129 (commenting generally on the limited case law specifically addressing the issue of springing guaranties); *Exploding and Springing Guarantees*, *supra* note 55 (noting that the courts have yet to consider the applicability of § 105 in the springing guaranty context).

217. *See* Complaint for Injunction, *In re Mkt. Ctr. E. Retail Prop., Inc.*, No. 09-11696-s11 (D.N.M. Sep. 1, 2009), ECF No. 69.

218. *See* First Fed. Sav. & Loan Ass'n of Little Rock v. Pettit, 12 B.R. 147, 148 (E.D. Ark. 1981) (explaining that the bankruptcy court's jurisdiction under the new Bankruptcy Code has been greatly expanded).

219. *See* Prestige Capital Corp. v. Michigan Gage & Mfg., LLC, 722 F. Supp. 2d 837, 839 (E.D. Mich. 2010) (taking note of the lender's failure to cite to New Jersey law in support of its Motion for Summary Judgment based on breach of a personal guaranty agreement). In *Prestige*, a Michigan district court sitting in diversity applied

springing guaranty to be enforceable.[220] In *Monroe*, two New Jersey state courts confronted the issue of whether to enforce a springing guaranty.[221] The trial court enforced the springing guaranty based on a strict application of contract law principles.[222] On appeal, the appellate division affirmed.[223] In so holding, the appellate division considered whether § 365(e)'s prohibition of *ipso facto* clauses applied to a non-debtor guarantor.[224] The appellate division agreed with the trial court's interpretation of § 365(e) as only invalidating executory contracts or unexpired leases *of the debtor*.[225] On that basis, the appellate division held that the borrower's bankruptcy filing does not protect the guarantor from personal liability because the guarantor is not the debtor.[226] As the guarantor on the loan, the carve-out agreement constitutes "'an independent obligation' of [the guarantor] which 'happens to have been triggered' by [the borrower's] default and resort to bankruptcy."[227] Therefore, the appellate division relied on two separate holdings in concluding that § 365(e) did not apply.[228] First, the court held that the carve-out agreement was not an *ipso facto* clause because its enforcement was not contingent on the borrower's bankruptcy filing.[229] Second, the court held that the applicability of § 365(e) is limited to contracts or leases directly involving the debtor and not the debtor's guarantor.[230] However, the appellate division did recognize and accept the trial court's implicit limitation on the scope of its holding.[231] The trial court noted that its holding might have been different had the guarantor presented evidence that the lender would be fully protected by

---

New Jersey law pursuant to the choice-of-law provision in the parties' guaranty agreement. *Id.*

220. Monroe Ctr. II Urban Renewal Co. LLC v. Strategic Performance Fund-II, Inc., 2010 WL 5343317 (N.J. Super. Ct. App. Div. Dec. 29, 2010).

221. *Id.*

222. *Id.*

223. *Id.* at *3.

224. *Id.* at *2.

225. *Id.* at *3.

226. *Id.*

227. *Id.* (citing Liberty Mut. Ins. Co. v. Greenwich Ins. Co., 286 F. Supp. 2d 73 (D. Mass. 2003), *aff'd by*, 417 F.3d 193 (1st Cir. 2005)).

228. *Id.*

229. *Id.*

230. *Id.*

231. *Id.*

the collateral securing its loan, and thus, enforcement of the carve-out agreement against the guarantor personally would merely result in a windfall to the lender.[232] Still, if the *Monroe* case offers insight into the future, it is probable that the Third Circuit will continue to favor the enforcement of springing guaranties.[233]

At least to a certain extent, there is an internal split within both the Second and Ninth Circuits.[234] In the Ninth Circuit, there is on-point case law, but it provides very little guidance on how courts within this circuit

232. *Id.* (distinguishing *In re* Rose, 29 B.R. 272 (D.N.J. 1982)).

233. *See id.*

234. The large majority of bankruptcy-triggered springing guaranty cases from the Second Circuit hold in favor of the lender. *See* UBS Commercial Mortg. Trust 2007-FL1 v. Garrison Special Opportunities Fund L.P., No. 652412, slip op. at 7 (N.Y. Sup. Ct. 2011) (enforcing springing guaranty pursuant to its terms); *see also* Bank of Am. v. Lightstone Holdings, LLC, No. 601853, slip op. at 1, 6 (N.Y. Sup. Ct. 2011) (permitting lender to collect $100 million liability from guarantor); *In re* S. Side House, LLC, 470 B.R. 659, 659 (Bankr. E.D.N.Y. 2012) (proposing district court enter final judgment enforcing the guaranty); Wells Fargo Bank Minnesota v. Rouleau, 46 A.3d 905, 912 (Vt. 2012) (enforcing springing guaranty triggered by borrower's bankruptcy filing); GCCFC 2006-GG7 Westheimer Mall, LLC v. Okun, No. 07 CIV. 10394 (NRB), 2008 WL 3891257, at *1 (S.D.N.Y. Aug. 21, 2008) (permitting lender to collect from the guarantor, despite the fact that lender also held proofs-of-claims in the borrower's bankruptcy case); First Nationwide Bank v. Brookhaven Realty Assocs., 223 A.D.2d 618, 620, 621 (N.Y. App. Div. 1996) (rejecting the debtor and guarantor's § 365(e) argument and enforcing the springing guaranty). However, there is at least one exception. *See In re* Kingston Square Assocs., 214 B.R. 713, 713 (Bankr. S.D.N.Y. 1997) (permitting the guarantor to authorize both the bankruptcy filing, while also avoiding being held liable under the terms of the guaranty). In addition, the willingness of at least one Second Circuit springing guaranty case, albeit not triggered by a bankruptcy-related event, to limit the lender's recovery lends support to the potential for a Second Circuit springing guaranty case to hold in favor of the guarantor in the future. *See* ING Real Estate Fin. LLC v. Park Ave. Hotel Acquisition LLC, No. 601860, slip op. at 5 (N.Y. Sup. Ct. 2010) (declining to enforce a penalty far in excess of the expected actual loss to the lender). It is even more difficult to predict the outcome of a bankruptcy-triggered springing guaranty case in the Ninth Circuit. *See* JPMCC 2007-C1 Grasslawn Lodging, LLC v. Dix, No. CV-11-00017-TUC-CKJ, 2013 WL 1340039, at *9 (D. Ariz. Apr. 1, 2013) (enforcing the springing guaranty pursuant to its terms). *But see* Bank of Am. v. Lahave, No. B237360, 2013 WL 1208423, at *7 (Cal. Ct. App. Mar. 26, 2013) (declining to enforce a penalty that went "beyond compensation into punishment").

will hold in the future.[235] The Second Circuit is more consistent than the Ninth Circuit in its enforcement of springing guaranties.[236] As compared to the other circuits, a relatively high number of bankruptcy-related springing guaranty cases have arisen in the Second Circuit.[237] Although the Second Circuit has held for the guarantor in some non-bankruptcy related springing guaranty cases, all but one of the Second Circuit's bankruptcy-triggered springing guaranty cases hold against the guarantor.[238]

The Second Circuit is not alone: in every other circuit that has addressed this issue, a majority of courts have enforced the springing guaranty against the guarantor.[239] Courts located in the Fourth,[240]

---

235. *See Dix,* 2013 WL 1340039, at *9 (enforcing the springing guaranty). *But see Lahave*, 2013 WL 1208423, at *7 (voiding the springing guaranty).

236. *In re S. Side House, LLC*, 470 B.R. 659, 687-88; *Rouleau*, 46 A.3d 905, 912; *UBS Commercial Mortg. Trust 2007-FL1*, No. 601853; *Lightstone Holdings*, No. 601853; *Okun*, 2008 WL 3891257, at *4; *First Nationwide Bank,* 223 A.D.2d at 637 (enforcing the springing guaranties).

237. *In re S. Side House, LLC*, 470 B.R. 659, 687-88; *Rouleau*, 46 A.3d 905, 912; *UBS Commercial Mortgage Trust 2007-FL1*, No. 652412; *Lightstone Holdings*, No. 601853; *Okun,* 2008 WL 3891257, at *4; *First Nationwide Bank*, 223 A.D.2d at 637; *In re Kingston Square Assocs.*, 214 B.R. 713, at 738-39.

238. *In re Kingston Square Associates,* 214 B.R. 713, at 738-39 (holding in favor of the guarantor). *But see In re* S. *Side House, LLC*, 470 B.R. 659, 687-88; *Rouleau*, 46 A.3d 905, 912; *UBS Commercial Mortgage Trust 2007-FL1*, No. 652412; *Lightstone Holdings*, No. 601853; *Okun*, 2008 WL 3891257, at *4; *First Nationwide Bank*, 223 A.D.2d at 637 (holding against the guarantor).

239. *See* LBCMT 2007-C3 Urbana Pike, LLC v. Sheppard, No. CIV. JKB-12-3056, 2014 WL 1388409 (D. Md. Apr. 9, 2014); *see also* FDIC v. Prince George Corp., 58 F.3d 1041, 1046 (4th Cir. 1995) (enforcing the springing guaranty in the Fourth Circuit); LBUBS 2004-C8 Derek Drive, LLC v. Gerbino, No. 2:13-CV-2264, 2014 WL 2446362 (W.D. La. May 30, 2014); LBCMT 2007-C3 Seminole Trail, LLC v. Sheppard, No. 3:12CV00025, 2013 WL 3009319 (W.D. Va. June 17, 2013); LBCMT 2007-C3 Sterling Retail, LLC v. Sheppard, No. 1:12-CV-470, 2013 WL 2151683 (E.D. Va. May 15, 2013); U.S. Bank Nat'l Ass'n v. Cotta, No. 11-CV-410, 2012 WL 5335999 (S.D. Tex. Oct. 26, 2012); Wells Fargo Bank, Nat'l Ass'n v. Singh, No. CIV.A. H-12-0147, 2012 WL 3186036 (S.D. Tex. Aug. 2, 2012); 8375 Honeytree Blvd. Holdings, LLC v. Starman, No. 11-12431, 2012 WL 683379 (E.D. Mich. Mar. 2, 2012); Wells Fargo Bank v. Daniels, Nos. C-110209, C-110215, 2001 WL 6677982 (Ohio Ct. App. Dec. 21, 2011) (enforcing the springing guaranty in the Sixth Circuit); Wells Fargo Bank Minnesota v. Kobernick, No. C.A. 8-CV-1458, 2009 WL 7808949 (S.D. Tex. May 28, 2009), *aff'd sub nom.*, U.S. Bank, Nat'l Ass'n v. Kobernick, 454 F. App'x 307 (5th Cir. 2011) (enforcing the springing guaranty in the Fifth Circuit); 111

Fifth,[241] and Sixth[242] Circuits have enforced springing guaranties more often than not. In the Sixth Circuit, it is not just the courts dictating the enforceability of springing guaranties; rather, the legislatures of two of the four states that are within the Sixth Circuit have enacted legislation addressing the issue.[243] Both Michigan and Ohio passed legislation largely curtailing the enforceability of springing guaranties.[244] Michigan passed the NMLA, and Ohio passed the LTA, respectively.[245] However, both the NMLA and the LTA are inapplicable in the event the guarantor's recourse liability is triggered as a result of the borrower's filing of a voluntary petition or the borrower's indirect filing—through collusion with creditors—of an involuntary petition for bankruptcy.[246] This is because both pieces of legislation only invalidate nonrecourse carve-outs that are based on the solvency of the borrower and explicitly exclude covenants against bankruptcy filings from the definition of a

---

Debt Acquisition LLC v. Six Ventures, Ltd., No. C2-08-768, 2009 WL 414181 (S.D. Ohio Feb. 18, 2009), *aff'd sub nom.*, 111 Debt Acquisition Holdings, LLC v. Six Ventures Ltd., 413 F. App'x 824 (6th Cir. 2011).

240. *See Prince George Corp.*, 58 F.3d at 1046; *LBCMT 2007-C3 Urbana Pike, LLC*, 2014 WL 1388409; *LBCMT 2007-C3 Seminole Trail, LLC*, 2013 WL 3009319; *LBCMT 2007-C3 Sterling Retail, LLC*, 2013 WL 2151683 (enforcing the springing guaranty in the Fourth Circuit).

241. *See, e.g.*, *Gerbino*, 2014 WL 2446362; *Cotta*, 2012 WL 5335999; *Singh*, 2012 WL 3186036; *Kobernick*, 2009 WL 7808949, *aff'd sub nom.*, *Kobernick*, 454 F. App'x 307 (enforcing the springing guaranty in the Fifth Circuit).

242. *See, e.g., 111 Debt Acquisition LLC*, 2009 WL 414181, *aff'd sub nom.*, *111 Debt Acquisition Holdings, LLC*, 413 F. App'x 824; *Starman*, 2012 WL 683379; *Daniels*, 2001 WL 6677982 (enforcing the springing guaranty in the Sixth Circuit).

243. The legislatures of two states within the Sixth Circuit invalidated all springing guaranties with the exception of those triggered by bankruptcy-related events. OHIO REV. CODE ANN. tit. XIII, § 1319.07 (West 2013); MICH. COMP. LAWS § 445.1592(d) (2012) (carving out an exception for bankruptcy-triggered springing guaranties in Ohio and Michigan).

244. LTA, H.B. 479, 129 Gen. Assemb., Reg. Sess. (Ohio 2012) (curtailing the enforceability of springing guaranties in Ohio); NMLA, 2012 Pub. Acts 67, MICH. COMP. LAWS § 445.1591 *et seq.* (2012) (curtailing the enforceability of springing guaranties in Michigan).

245. LTA, H.B. 479, 129 Gen. Assemb., Reg. Sess. (Ohio 2012); NMLA, 2012 Pub. Acts 67, MICH. COMP. LAWS § 445.1591 *et seq.*)

246. *See, e.g.*, *111 Debt Acquisition LLC*, 2009 WL 414181, *aff'd sub nom.*, *111 Debt Acquisition Holdings, LLC*, 413 F. App'x 824; *Starman*, 2012 WL 683379; *Daniels*, 2001 WL 6677982 (enforcing the springing guaranty in the Sixth Circuit).

post-closing solvency covenant.[247] The logic behind this exclusion was probably that since corporate debtors filing for bankruptcy protection under Chapter 11 are not per se insolvent, the legislation should not apply to bar the enforcement of springing guaranties triggered by the borrower's filing for bankruptcy, as opposed to those triggered by the borrower's insolvency.[248] However, in light of the close interconnection

---

247. OHIO REV. CODE ANN. tit. XIII, § 1319.07 (West 2013) (carving out an exception for bankruptcy-triggered springing guaranties in Ohio and Michigan); MICH. COMP. LAWS § 445.1592(d) (2012) (carving out an exception for bankruptcy-triggered springing guaranties in Ohio and Michigan); *see also* Borman, LLC v. 18718 Borman, LLC, No. 12-15567, 2014 WL 943181 (E.D. Mich. Mar. 11, 2014) (taking note of this exception in dicta).

248. *See Structuring Real Estate Loans*, *supra* note 41, at 27 (recognizing that this argument implicitly assumes guarantors and borrowers filing for bankruptcy are not actually insolvent, thereby creating a "very real dilemma" for borrowers and guarantors who file at a time when they are actually insolvent); *see also* Ohio Rev. Code Ann. tit. XIII, § 1319.07 (West 2013); Mich. Comp. Laws § 445.1592(d) (2012) (carving out an exception for bankruptcy-triggered springing guaranties in Ohio and Michigan). Homburger and Goodrich explain that a borrower is solvent if the value of the property subject to the lender's lien is greater than the balance owed by the borrower on the loan. *See Structuring Real Estate Loans*, *supra* note 39, at 18. Under Homburger and Goodrich's definition of "solvent," the typical guarantors in springing guaranty cases will almost never qualify. *Id.*; *see generally* Exhibit 1. However, because of the exclusion carved out for bankruptcy filings, the NMLA and LTA will not apply to bar the enforcement of springing guaranties even where the borrower is insolvent. *See* NMLA, MICH. COMP. LAWS § 445.1592(2)(d) (2012); LTA, OHIO REV. CODE ANN. § 1319.07(D) (West 2013). As was seen in the Lichtenstein case, this leaves the guarantor in a no-win situation:

> [the guarantor] was either going to be liable to (i) the lender under the springing guaranty for authorizing the filing of bankruptcy petition or (ii) each of the borrower's other creditors for breach of fiduciary duty in failing to authorize the bankruptcy filing since the borrower was insolvent at the time and owed a fiduciary duty to the creditors.

See Structuring Real Estate Loans, *supra* note 39, at 15 (citing Lichtenstein vs. Willkie Farr & Gallagher LLP, 2013 WL 1783571 (N.Y. Sup. Ct. Apr. 2013)). Thus, in practice, the deterrent effect of the bankruptcy-triggered springing guaranty virtually has put a halt to strategic filings by solvent borrowers to prevent a lender from foreclosing on its property. *See id.* Instead, the only insiders who still file in the face of their own personal liability pursuant to the guaranty are those with fiduciary duties to uphold as a result of the insolvency of the borrower. *See id.*

between those two happenstances, it seems counterintuitive to draw a bright line rule that limits the applicability of the Michigan and Ohio legislation to only some of the triggering conditions, especially in light of the public policy justifications behind the enactment of the NMLA and LTA.[249] Both the Michigan and Ohio legislatures provided the same rationale for the enactment of the NMLA and LTA, respectively:

> [t]he legislature[s] recognize[] that it is inherent in a nonrecourse loan that the lender takes the risk of a borrower's insolvency, inability to pay, or lack of adequate capital after the loan is made and that the parties do not intend that the borrower is personally liable for payment of a nonrecourse loan if the borrower is insolvent, unable to pay, or lacks adequate capital after the loan is made. The legislature[s] recognize[] that the use of a post closing solvency covenant as a nonrecourse carveout, or an interpretation of any provision in a loan document that results in a determination that a post closing solvency covenant is a nonrecourse carveout, is inconsistent with this act and the nature of a nonrecourse loan; is an unfair and deceptive business practice and against public policy; and should not be enforced.[250]

Based on this rationale, it is hard to see why neither the Michigan legislature nor the Ohio legislature felt that it was inherent in a nonrecourse loan that the lender takes the risk of a borrower's filing for bankruptcy or that a determination that a bankruptcy filing constitutes a nonrecourse carve-out was equally inconsistent with the nature of a nonrecourse loan and against public policy.[251] This is especially true in

---

249. LTA, H.B. 479, 129 Gen. Assemb., Reg. Sess. (Ohio 2012); NMLA, 2012 Pub. Acts 67, MICH. COMP. LAWS § 445.1591 *et seq.*; NMLA, 2012 Mich. Legis. Serv. P.A. 67, ¶ N.M.L.A. § 445.1591 Note (S.B. 992); Real Estate—Trusts and Trustees—Rules and Regulations, 2012 Ohio Laws File 201, ¶ Section 5 (Sub. H.B. 479).

250. NMLA, 2012 Mich. Legis. Serv. P.A. 67, ¶ N.M.L.A. § 445.1591 Note (S.B. 992); Real Estate—Trusts and Trustees—Rules and Regulations, 2012 Ohio Laws File 201, ¶ Section 5 (Sub. H.B. 479).

251. *See supra* note 250; *see also* LTA, H.B. 479, 129 Gen. Assemb., Reg. Sess. (Ohio 2012), OHIO REV. CODE § 1319.07(D); NMLA, 2012 Pub. Acts 67, MICH. COMP. LAWS § 445.1592(2)(d) (excepting bankruptcy-triggered springing guaranties from the definition of a post-closing solvency covenant). It seems that it would be more consistent with the intent of the legislation to provide for bankruptcy-triggered springing guaranties to be invalidated if at the time of filing, the amount due under the loan is greater than the value of the property securing the loan. *See supra* note 241 and accompanying text.

light of the conflict of interest such a nonrecourse carve-out creates for the guarantor in deciding whether or not to file for bankruptcy.[252] As a company approaches insolvency, the guarantor's fiduciary duties to the company's creditors and equity holders obligate the guarantor to file, but if the guarantor does file, he or she will be subject to recourse liability under the terms of the guaranty.[253] In essence, the inclusion in nonrecourse loans of covenants against bankruptcy filings creates a lose-lose situation for the guarantor.[254] That situation results in the borrower's delayed bankruptcy filing and a financially unsustainable debtor.[255] As a result, it is hard to believe that public policy could in some way support the permissibility of these covenants against bankruptcy filings.[256] For that reason, the Michigan and Ohio legislatures may eventually want to reconsider their exclusion of covenants against bankruptcy filings from the definition of a "post closing solvency covenant."[257]

As a result of the exclusion for bankruptcy filings carved out of both the NMLA and LTA, the triggering condition will often be of the utmost relevance in the Sixth Circuit.[258] Where the triggering condition is the filing of a bankruptcy petition, we can assume that this circuit will continue to permit enforcement of the springing guaranty.[259] However, it is less clear what the outcome will be if the triggering condition is a collateral consequence of the bankruptcy filing, i.e. the collateral securing the lender's lien becomes an asset in the bankruptcy case.[260]

---

252. *See Structuring Real Estate Loans*, *supra* note 39, at 15.

253. *Id.*; *see also Will Exploding Guaranties Bomb?*, *supra* note 4, at 132 n.19 (explaining who the debtor's management owes fiduciary duties to as the debtor approaches insolvency).

254. *Will Exploding Guaranties Bomb?*, *supra* note 4, at 132.

255. *See supra* note 43 and accompanying text.

256. *See supra* notes 250-51 and accompanying text (justifying the legislation in Ohio and Michigan on public policy grounds, but declining to also define nonrecourse loans triggered by bankruptcy-related carve-outs as against public policy).

257. LTA, H.B. 479, 129 Gen. Assemb., Reg. Sess. (Ohio 2012), OHIO REV. CODE § 1319.07(D); NMLA, 2012 Pub. Acts 67, MICH. COMP. LAWS § 445.1592(2)(d).

258. LTA, H.B. 479, 129 Gen. Assemb., Reg. Sess. (Ohio 2012), OHIO REV. CODE § 1319.07(D); NMLA, 2012 Pub. Acts 67, MICH. COMP. LAWS § 445.1592(2)(d).

259. LTA, H.B. 479, 129 Gen. Assemb., Reg. Sess. (Ohio 2012), OHIO REV. CODE § 1319.07(D); NMLA, 2012 Pub. Acts 67, MICH. COMP. LAWS § 445.1592(2)(d).

260. *See* LBCMT 2007-C3 Sterling Retail, LLC v. Sheppard, 1:12-CV-470, 2013 WL 2151683 (E.D. Va. May 15, 2013); Wells Fargo Bank Minnesota v. Kobernick,

The statutory wording excluding "a covenant not to file a voluntary bankruptcy or other voluntary insolvency proceeding" leaves room for the guarantor to argue that where the triggering condition is not explicitly the borrower's filing of a petition in bankruptcy, but rather the lender's collateral becoming an asset in that bankruptcy, the guaranty should not be enforced against the guarantor.[261] If courts agreed with this argument, the legislation would result in a nonsensical outcome: it would incentivize lenders to describe the trigger as the borrower's filing of a petition for bankruptcy.[262] Such an incentive could result in an even greater deterrence of subsequent bankruptcy filings through the encouragement of filing-related language in the guaranty agreement.[263] As of now, no cases have arisen in either Michigan or Ohio to answer the question of whether a springing guaranty triggered by the lender's collateral becoming an asset in bankruptcy is enforceable.[264] If it is not

---

C.A. 8-CV-1458, 2009 WL 7808949 (S.D. Tex. May 28, 2009), *aff'd sub nom.*, U.S. Bank, Nat'l Ass'n v. Kobernick, 454 F. App'x 307 (5th Cir. 2011) (addressing springing guaranties triggered by the lender's collateral becoming an asset in a subsequent bankruptcy proceeding).

261. OHIO REV. ANN. CODE tit. XIII, § 1319.07 (2013); 2012 Mich. Pub. Acts 67 § 445.1592(2)(d).

262. OHIO REV. ANN. CODE tit. XIII, § 1319.07 (2013); 2012 Mich. Pub. Acts 67 § 445.1592(2)(d).

263. OHIO REV. ANN. CODE tit. XIII, § 1319.07 (2013); 2012 Mich. Pub. Acts 67 § 445.1592(2)(d).

264. *See* Charles R. Gibbs et al., *Securitized Commercial Loans in Bankruptcy*, MORTGAGE AND ASSET BACKED SECURITIES LITIGATION HANDBOOK § 7:23 (October 2014) ("[I]t remains to be seen whether a court ruling on the enforceability of a carve-out guarantee, that is triggered by the initiation of bankruptcy proceedings, will uphold the carve-out guarantee as valid."); *see also* Borman, LLC v. 18718 Borman, LLC, No. 12-15567, 2014 WL 943181 (E.D. Mich. Mar. 11, 2014) (granting summary judgment to the guarantor). In *Borman*, the court held that Michigan's NMLA barred enforcement of the lender's claim for a deficiency judgment against the guarantor. *Borman*, 2014 WL 943181, at *13. In so holding, the Court explained that the NMLA's definition of a post closing solvency covenant applied to provisions, where the triggering condition was the borrower's failure to pay its debts. *Id.* Since the borrower's failure to pay was the condition allegedly triggering the guarantor's liability therein, the court concluded that the NMLA precluded its enforcement of the springing guaranty agreement. *Id.* The court noted in passing that were the triggering condition instead a covenant not to file for bankruptcy, the guarantor could still be held liable because the NMLA would not apply. *Id*. The court does not attempt to predict the enforceability of provisions excluded from the NMLA explicit discussion in § 4.2(j), such as the lender's collateral becoming an asset in bankruptcy. *Id.*

enforceable, lenders who otherwise would have described the trigger in that manner will instead describe the trigger as the borrower's filing.[265] This enables lenders to achieve their intended effect—the deterrence of subsequent bankruptcy filings—while also preserving their right to enforce the guaranty agreement against the guarantor.[266]

In other circuits, where the triggering condition relates to bankruptcy, the actual language used to describe that trigger becomes largely irrelevant.[267] Both the Fourth Circuit's *Sterling Retail* case and the Fifth Circuit's *Kobernick* case provide useful examples of how triggers other than the actual filing of a petition can still achieve the same outcome.[268] In those cases, the trigger was not the actual bankruptcy filing.[269] Instead, the guarantor's liability was triggered when the collateral securing the lender's loan became an asset in the borrower's bankruptcy case.[270] Regardless, the effect is the same.[271] Since all of the debtor's property is transferred to the bankruptcy estate

265. OHIO REV. ANN. CODE tit. XIII, § 1319.07 (2013); 2012 Mich. Pub. Acts 67 § 445.1592(2)(d); *see also Borman*, 2014 WL 943181, at *13 (noting that the NMLA is inapplicable to covenants not to file for bankruptcy).

266. *See Borman*, 2014 WL 943181, at *13 (noting in dicta that where the triggering condition is a covenant not to file for bankruptcy, the NMLA will not preclude the guarantor's liability for breaching that covenant); *see also Exploding and Springing Guarantees*, *supra* note 55, at 1 (explaining that the lender is seeking to discourage the occurrence of some undesirable effect, e.g. the filing of bankruptcy).

267. The majority of these courts nonetheless enforce the springing guaranty regardless of whether the trigger is the borrower's filing for bankruptcy or the lender's collateral becoming an asset in the borrower's bankruptcy case. *See* Exhibit 3, columns (c), (e).

268. LBCMT 2007-C3 Sterling Retail, LLC v. Sheppard, 1:12-CV-470, 2013 WL 2151683, at *2 (E.D. Va. May 15, 2013); Wells Fargo Bank Minnesota v. Kobernick, C.A. 8-CV-1458, 2009 WL 7808949, at *4 (S.D. Tex. May 28, 2009), *aff'd sub nom.*, U.S. Bank, Nat'l Ass'n v. Kobernick, 454 F. App'x 307 (5th Cir. 2011).

269. *Sheppard*, 2013 WL 2151683, at *2 (discussing the lender's argument that the guarantors "are personally liable for the entire debt if the property or any part thereof becomes as asset in a voluntary bankruptcy proceeding"); *Kobernick*, 2009 WL 7808949, at *4 (addressing the lender's argument that the guarantor has recourse liability because the guarantor filed the borrower's bankruptcy listing the lender's property as the borrower's sole asset, thereby violating the terms of the note).

270. *See Sheppard*, 2013 WL 2151683, at *2; *Kobernick*, 2009 WL 7808949, at *4 (addressing springing guaranties triggered by the lender's collateral becoming an asset in a subsequent bankruptcy proceeding).

271. *Sheppard*, 2013 WL 2151683, at *2; *Kobernick*, 2009 WL 7808949, at *4.

upon commencement of the bankruptcy case, the collateral's becoming an asset in the bankruptcy case is coextensive with the borrower's filing of the bankruptcy petition.[272] It is irrelevant whether the guaranty agreement provides that a default occurs in the event of the borrower's actual filing or in the event of the collateral becoming a bankruptcy asset.[273] Both achieve the same ultimate goal of the lender—to deter the borrower from ever undergoing bankruptcy.[274]

In sum, as the law exists today, the large majority of jurisdictions uphold the validity of enforcing these springing guaranties.[275] State courts frequently issue decisions, which are almost always grounded in a strict application of contract law principles, to enforce springing guaranties.[276] Most of these courts still hold the same way regardless of the exorbitant liability provided for in the guaranty agreement.[277] For instance, the New York Supreme Court held one guarantor personally liable for $100 million pursuant to a "bad boy" guaranty agreement.[278] However, the dearth of case law with respect to this particular issue means that it is still unclear whether or not courts will continue to

---

272. *Sheppard*, 2013 WL 2151683, at *2; *Kobernick*, 2009 WL 7808949, at *4; *see also* 11 U.S.C. § 541(a)(1) (2012) (defining the debtor's property to include all of the debtor's property at the time of the filing of the petition).

273. *See* Charles R. Gibbs et al., *supra* note 263; *see also* Borman, LLC v. 18718 Borman, LLC, No. 12-15567, 2014 WL 943181, at *13 (E.D. Mich. Mar. 11, 2014).

274. *See Guaranties in Bankruptcy*, *supra* note 216, at 21 (explaining how springing guaranties allow lenders to discourage borrowers and their equity holders from filing for bankruptcy).

275. *See* Exhibit 3, column (c) (illustrating that most courts considering the springing guaranty issue enforce the guaranty agreement pursuant to its terms).

276. *See* Wells Fargo Bank Minnesota v. Rouleau, 46 A.3d 905, 908 (Vt. 2012) ("Personal guaranties are contracts governed by general principles of contract law."); *see also* UBS Commercial Mortg. Trust 2007-FL1 v. Garrison Special Opportunities Fund L.P., 2011 N.Y. Slip Op. 51774(U) (N.Y. Sup. Ct. Mar. 8, 2011) (limiting the role of the court to upholding freely entered into contractual arrangements pursuant to legislative enactments and common law precedents); Bank of Am. v. Lightstone Holdings, 938 N.Y.S.2d 225 (N.Y. Sup. Ct. 2011); First Nationwide Bank v. Brookhaven Realty Assocs., 637 N.Y.S.2d 418 (N.Y. App. Div. 1996); Monroe Ctr. II Urban Renewal Co., LLC v. Strategic Performance Fund-II, No. C-52-08, 2010 WL 5343317, at *3 (N.J. Super. Ct. App. Div. Dec. 29, 2010); Wells Fargo Bank v. Daniels, No. C-110209, 2011 WL 6677982 (Ohio Ct. App. Dec. 21, 2011) (enforcing the springing guaranty based on a strict application of contract law principles).

277. *See* Exhibit 3, column (c).

278. *Lightstone Holdings*, 938 N.Y.S.2d at *1, *6 (N.Y. Sup. Ct. 2011).

enforce these guaranties in the future.[279] If a recent ruling by an appellate court in California applying New Mexico law provides any guidance to courts within the Ninth and Tenth Circuits, then these courts may be more inclined to invalidate springing guaranties triggered by bankruptcy-related events.[280] Many of these guaranty agreements provide for recourse liability upon the borrower's default.[281] This, in turn, enables the lender to immediately sue the guarantor for any outstanding amount due under the loan, including any deficiency that would not be covered by the collateral's value.[282] However, in *Bank of America v. Lahave*, the trial court only permitted the lender to recover from the guarantor five percent of what was still owed under the loan.[283] The court of appeals held that even that small percentage should not have been enforced.[284] Given the limited case law dealing with springing guaranties triggered by bankruptcy filings, the willingness of any court to define a five percent late fee as a penalty does not bode well for future lenders.[285] Over the years, the springing guaranty device has also been the subject of increasing pushback by commentators, who in large part argue against the enforcement of this device based on the policy reasons underlying the Code.[286] Still, the majority of courts rely on the

279. *See* Eisenson, *supra* note 1, at 263 (noting that the limited number of courts that have considered whether full recourse liability constituted an unenforceable penalty have held that full recourse damages is enforceable based on contract law).

280. Bank of Am. v. Lahave, No. B237360, 2013 WL 1208423, at *4 (Cal. Ct. App. Mar. 26, 2013).

281. *See Guaranties in Bankruptcy*, *supra* note 216 ("'Bad boy' or springing guaranties allow lenders to continue to offer 'optically' non-recourse loans while discouraging borrowers and their equity holders from taking certain actions (e.g., filing for bankruptcy) by enumerating events that will (i) trigger recourse on the primary obligation and (ii) cause the guaranty to 'spring' into life, making the guarantor fully liable for the underlying debt.").

282. *See id.* at 21, 23; *see also* Adams, Jr. & Kirkham, *supra* note 1, at 301.

283. *Lahave*, 2013 WL 1208423, at *2.

284. The California Court of Appeals reasoned: "a Late Fee consisting of 5 percent of the balance of a note constitutes a penalty unenforceable as a matter of public policy under New Mexico law against Guarantors, notwithstanding their purported waiver of any invalidity, illegality, or unenforceability of the note." *Id.* at *4.

285. *Id.* at *1 ("We are asked to determine whether a late fee consisting of 5 percent of the balance of a note constitutes a penalty. . . . . We conclude . . . the late fee constitutes a penalty . . . and therefore is unenforceable.").

286. *See* Marshall E. Tracht, *Insider Guaranties in Bankruptcy: A Framework for Analysis,* 54 U. MIAMI L. REV. 497, 554 (2000) (encouraging the bankruptcy court to

four corners of loan documents in enforcing these springing guaranties.[287]

b. The Factors

Therefore, the following are the most pertinent factors a bankruptcy court should consider in determining whether to enjoin a springing guaranty pursuant to § 105: (1) evidence of the insider's pre-filing delay leading to financial deterioration of the corporate debtor in the months preceding the debtor's filing for bankruptcy; (2) viability—the debtor's prospect of undergoing a successful reorganization; (3) the number of other creditors in the debtor's bankruptcy case in a position to be harmed by the enforcement of the guaranty for the benefit of a single creditor; (4) the timing of the bankruptcy case vis-à-vis the springing guaranty proceeding—i.e. whether the bankruptcy case has already been dismissed or converted to Chapter 7; (5) whether it is a state, district, or bankruptcy court presiding over the springing guaranty proceeding; and (6) the specific language of the guaranty defining the forum in which subsequent issues are to be resolved.[288] Hopefully, an increasing number of bankruptcy courts will preside over springing guaranty proceedings in the future.[289] This would enable the development of a more coherent

rely on the policies underlying § 362 and § 365(e) of the Code to protect a viable debtor's prospects of undergoing a successful reorganization); *Exploding and Springing Guarantees*, *supra* note 55 (discussing the potential invocation of the equitable subordination provision of the Code to subordinate the lender's claim in the borrower's bankruptcy case); *see also* 11 U.S.C. § 362 (2012) (providing for the debtor's automatic stay); *id.* § 365(e) (invalidating *ipso facto* clauses contingent upon the solvency of the debtor); *id.* § 510(c) (permitting the subordination or disallowance of the claim of an overreaching lender or a lender exerting excessive control in the bankruptcy case to the detriment of the debtor).

287. *See* Exhibit 3, column (c) (illustrating the cases in which the court enforced the springing guaranty pursuant to the terms of the guaranty agreement).

288. *See* Exhibit 1. In compiling these factors, I relied on my case study that constitutes the basis for Exhibits 1 and 2. *Id.*; *see also* Exhibit 2. I compared the court's analysis in each of those springing guaranty cases to discern whether any patterns arose. *See* Exhibit 1. These are the factors that were most consistently referenced in analyzing the springing guaranty issue. *Id.*

289. *See Will Exploding Guaranties Bomb?*, *supra* note 4, at 131 (noting the absence of bankruptcy court opinions involving springing guaranty cases susceptible to strong bankruptcy policy arguments).

framework for determining what fact-patterns justify the granting of injunctive relief.[290]

III. SOLUTION TO THE JURISDICTIONAL CONFLICT, SUBSTANTIVE REFRAMING AS A SOLUTION, AND SOLUTION TO THE SUBSTANTIVE CONFLICT

This Part proposes solutions to the jurisdictional and substantive issues raised in Parts I and II. Part III.A proposes a solution as to the procedural conflict: a bankruptcy court may exercise jurisdiction either on the ground that bankruptcy-triggered springing guaranty proceedings can only "arise in" the context of a bankruptcy case or on the ground that these proceedings are sufficiently "related to" the bankruptcy case. Part III.B considers potential ways for a guarantor who holds a controlling stake in the corporate debtor to act through the debtor in order to confer jurisdiction over the springing guaranty issue on a bankruptcy court. Part III.C proposes a solution as to the substantive conflict: the bankruptcy court should rely on their equitable powers pursuant to § 105 to preclude the enforcement of springing guaranties.

A. JURISDICTIONAL SOLUTIONS: "CORE," "ARISING IN" JURISDICTION AND "NON-CORE," "RELATED TO" JURISDICTION

The bankruptcy court can exercise "arising in" jurisdiction over the springing guaranty proceeding.[291] A proceeding that "arises in" the debtor's bankruptcy case falls within the bankruptcy court's "core" jurisdiction.[292] For a bankruptcy court to rely upon its "arising in" jurisdiction, the dispute must involve a claim that could only "arise in" the context of a bankruptcy case.[293] Therefore, a matter that "arises in"

---

290. *Id.*

291. *See* 28 U.S.C. § 1334(b) (providing the district court with original but not exclusive jurisdiction over all civil proceedings "arising in" a bankruptcy case); *see also id.* § 157(a) (permitting the district court to refer all proceedings "arising in" a bankruptcy case to the bankruptcy court).

292. *See id.* § 157(b) (designating proceedings that "arise in" a bankruptcy case as "core" proceedings).

293. *See* Stoe v. Flaherty, 436 F.3d 209, 218 (3d Cir. 2006) (explaining that claims that "arise in" a bankruptcy case are claims that—by their very nature—could arise only in the context of a bankruptcy case).

the context of a bankruptcy case cannot be "the subject of a lawsuit absent the filing of a bankruptcy case."[294] Thus, a springing guaranty proceeding, which arises as a result of the borrower's filing a bankruptcy petition, can never be the subject of a lawsuit absent the filing of a bankruptcy case.[295] If the triggering event (e.g., filing a Chapter 11 bankruptcy petition or any of the collateral consequences of a bankruptcy filing) never occurs, there will be no liability under the springing guaranty.[296] Consequently, the issue of whether to enforce that guaranty would never become the subject of a lawsuit.[297] Therefore, where the guarantor's personal liability only arises as a result of the debtor's bankruptcy filing, any attempt by the lender to enforce that liability of the guarantor necessarily "arises in" the context of the underlying bankruptcy case.[298] The entire basis for the lender's suit to enforce the guaranty is predicated on the guarantor's breach of the terms of the guaranty agreement by authorizing the debtor's filing of a petition in the bankruptcy court.[299] The guarantor's liability consequently "arises in" the debtor's bankruptcy case.[300] Indeed, without the bankruptcy case, the guarantor would not be liable in the first place.[301]

If a proceeding is "related to" the debtor's bankruptcy case, the bankruptcy court may exercise "non-core" jurisdiction over that proceeding.[302] The test to determine whether a proceeding is "related to" the debtor's bankruptcy case is whether the outcome of that proceeding could conceivably affect the administration of the debtor's estate in bankruptcy.[303] Here, the outcome of a springing guaranty proceeding

---

294. *Id.* (quotations omitted).

295. *See Exploding and Springing Guarantees*, *supra* note 55, at 1 (explaining that "the guarantor's liability springs into existence only upon . . . the filing of bankruptcy").

296. *See* Eisenson, *supra* note 1, at 262, 262 n. 106 (describing bad boy guaranties, a synonym for springing guaranties, as "a personal guaranty that is contingent upon bankruptcy filings").

297. *See Exploding and Springing Guarantees*, *supra* note 55, at 1.

298. *Id.*

299. *Id.* ("[T]he guarantor's liability springs into existence only upon . . . the filing of bankruptcy.").

300. *Id.*

301. *See supra* note 295 and accompanying text.

302. *See supra* note 14 and accompanying text.

303. *See, e.g.*, Pacor, Inc. v. Higgins, 743 F.2d 984, 994 (3d Cir. 1984).

will affect the administration of the debtor's bankruptcy estate.[304] Assuming the springing guaranty is enforced, the guarantor will either rely upon insurance provided by the debtor, exercise a right of indemnification against the debtor, or assert a contribution or subrogation claim in the debtor's bankruptcy case.[305] To pay off any and all of those claims, funds must be paid out of the debtor's estate to the detriment of other creditors in the bankruptcy.[306] If the presiding court found the springing guaranty to be unenforceable, the lender would be forced to assert its claim in the borrower's bankruptcy case.[307] This would permit the bankruptcy court to retain its usual discretion to restructure the terms of the loan so as to facilitate the debtor's reorganization.[308] Any unsecured deficiency would almost certainly be eliminated, and there would be no prior judgment entered in state court as to the amount due and owed under the loan.[309]

---

304. *See, e.g.*, SL Inv. US-Re Holdings 2009-1, Inc. v. Englett, No. 609-CV-281-ORL-28DAB, 2009 WL 1659164, 127-28 (M.D. Fla. June 12, 2009). For a discussion of the court's treatment of the springing guaranty proceeding in *Englett*, see *supra* notes 126-131 and accompanying text.

305. *See, e.g.*, *In re* Quigley Co., 676 F.3d 45, 53 (2d Cir. 2012) (explaining when the guarantor would have a right of indemnification against the debtor, thereby conferring related to jurisdiction on the bankruptcy court); *see* A.H. Robins Co. v. Piccinin, 788 F.2d 994, 1001–02 (4th Cir. 1986) (indicating that the bankruptcy court has jurisdiction over proceedings that will trigger a claim by the guarantor under an insurance policy owned by the debtor); *Guaranties in Bankruptcy*, *supra* note 216 (noting that, generally, the guarantor may exercise its right of reimbursement, contribution, or subrogation in the debtor's bankruptcy case); *see also* 11 U.S.C. § 509 (2012) (providing for the subrogation of certain claims of co-debtors); *id.* § 502 (providing guarantor with the right to assert a claim for reimbursement or contribution).

306. *See Englett*, 2009 WL 1659164, at *1 (noting that the amount collected from the guarantor in state court will reduce the amount owed by the debtor to the lender and thus conceivably will have an affect on the liability of the debtor's bankruptcy estate).

307. *See Will Exploding Guaranties Bomb?*, *supra* note 4, at 135 (illustrating why the bankruptcy court should retain jurisdiction over springing guaranty proceedings and how that court should invoke its § 105 equitable powers to enjoin its enforcement).

308. *See id.* at 134 (explaining the manner in which the springing guaranty removes much of the debtor's traditional ability to renegotiate loan terms).

309. *See generally* Adams, Jr. & Kirkham, *supra* note 1 (providing an in-depth analysis of how and why lenders seek to avoid the risk associated with a borrower's commencement of a Chapter 11 case).

B. EXPLORING GUARANTOR'S ABILITY TO CONFER "ARISING UNDER" JURISDICTION EXCLUSIVELY ON A BANKRUPTCY COURT AND TO ELIMINATE THE JURISDICTIONAL BAR POSED BY THE DOCTRINE OF MANDATORY ABSTENTION

A guarantor can manipulate the procedural laws governing springing guaranty proceedings to secure both protection from lenders seeking to collect on the debt and exclusive jurisdiction for a bankruptcy court.[310] By orchestrating the simultaneous filing of a Chapter 11 petition with a motion to modify the automatic stay, the guarantor, acting through the debtor, can eliminate the existing threats to the bankruptcy court's jurisdiction over a springing guaranty proceeding.[311] Section 362 of the Code provides for an automatic stay enjoining creditors from either commencing or continuing any attempts to recover a debt upon a debtor's filing for Chapter 11 bankruptcy.[312] Because a guarantor's motion to modify an automatic stay "arises under" the Code, that motion is a "core" proceeding under § 157.[313] Thus, if a guarantor, acting through the debtor, and a debtor concurrently submit their respective filings, the bankruptcy court will have "core" jurisdiction over the springing guaranty proceeding and remain insulated from the threat of remand under the doctrine of mandatory abstention.[314]

Accordingly, this Subpart explains how a guarantor can ensure that a bankruptcy court will continue to preside over the springing guaranty issue by: (1) framing the argument as grounded in § 362 of the Code, and (2) ensuring that the lender is precluded from initiating a state court proceeding prior to the initiation of the springing guaranty proceeding in the bankruptcy court.[315] The statutorily-defined doctrine of mandatory abstention places the burden on the party invoking the doctrine to prove

---

310. *See* 11 U.S.C. § 362(a) (creating the automatic stay barring post-filing attempts to collect from the debtor).

311. *Id.*

312. *Id.*

313. *See* 28 U.S.C. § 157(b)(1), (b)(2)(G) ("Core proceedings include, but are not limited to—(G) motions to . . . modify the automatic stay[.]"); *see also supra* note 136 and accompanying text.

314. 28 U.S.C. § 157(b)(1), (b)(2)(G); *see supra* note 34 and accompanying text.

315. *See* 28 U.S.C. § 157(b)(2)(G) (identifying a proceeding to modify the automatic stay as a "core" proceeding).

that under the present circumstances, the court must abstain.[316] The moving party must prove the following six factors:

> (1) the motion to abstain was timely; (2) the action is based on a state law claim; (3) the action is "related to" but not "arising in" a bankruptcy case or "arising under" the Bankruptcy Code; (4) Section 1334 provides the sole basis for federal jurisdiction; (5) an action is commenced in state court; [and] (6) that action can be "timely adjudicated" in state court.[317]

For a court to apply the jurisdictional bar of mandatory abstention, all of the enumerated factors must be present.[318] Section 1334(c)(2) sets forth specific requirements that a lender must satisfy to succeed on a motion to invoke the doctrine.[319] At the time the lender brings the mandatory abstention motion before the Bankruptcy Court, the lender must have already commenced an action in state court.[320] Therefore, if the debtor raises the issue that is to become the subject of the mandatory abstention proceeding in the bankruptcy court before the lender has initiated an action concerning that proceeding in state court, then the lender is precluded from relying upon the doctrine of mandatory abstention.[321] Therefore, this six-pronged test affords a guarantor the chance to ensure a proceeding will fall exclusively within the jurisdiction of a bankruptcy court.[322]

It is possible for a guarantor to circumvent the jurisdictional bar of mandatory abstention.[323] Where a proceeding "arises under" the Code and an action in state court has not commenced, the bankruptcy court is not required to abstain from hearing that proceeding.[324] Thus, a

316. *Id.*; *see* Stoe v. Flaherty, 436 F.3d 209, 219 n. 5 (3d Cir. 2006) (explaining that the party moving for mandatory abstention "had the burden of proving his right to mandatory abstention").

317. *In re* Refco, Inc. Sec. Litig., 628 F. Supp. 2d 432, 445 (S.D.N.Y. 2008); *see supra* note 38 and accompanying text.

318. *See* 28 U.S.C. § 1334(c)(2) (setting forth the mandatory abstention doctrine).

319. *Id.*

320. *See id.* § 1334(c)(2) (imposing the requirement that the district court abstain from hearing a proceeding only where the moving party has already filed an action in state court concerning the subject of that proceeding).

321. *Id.*

322. *Id.*

323. *See id.*

324. *Id.*

guarantor can preempt any subsequent finding of mandatory abstention by coordinating with the debtor to file simultaneously the guarantor's motion to modify the automatic stay and the debtor's Chapter 11 petition.[325] In effect, the debtor's filing would render it impossible to satisfy the third and fifth factors required under the statute.[326] The debtor's filing would forestall demonstration of the third factor because mandatory abstention only applies to "non-core" proceedings, and a motion to modify the automatic stay is a "core" proceeding under § 157.[327] Similarly, the debtor's filing would prevent satisfaction of the fifth requirement because it becomes impossible for the lender to commence an action in state court when the guarantor files a motion to modify the automatic stay on the same day the debtor files its bankruptcy petition.[328]

---

325. *Id.* One can assume that the guarantor who is the individual with the authority to authorize or decline to authorize the debtor's bankruptcy filing can equally exercise this same authority over the debtor to also file a motion to modify the automatic stay on the guarantor's behalf. *See* Eisenson, *supra* note 1, at 263 ("By imposing personal liability on a guarantor, which is usually a person in control of the borrower, bad boy guaranties create a financial disincentive for the guarantor to cause, or even permit, the borrower to impede the lender's collateral enforcement action by filing a bankruptcy petition."); *see also Will Exploding Guaranties Bomb?*, *supra* note 4, at 136 ("[A] bankruptcy-contingent guaranty is not, at its core, an obligation of a third party or a contract of financial assurance; it is a bonding device used to control the business decisions of the debtor, with financial liability imposed on the principals as a penalty for breach.").

326. *See* 28 U.S.C. § 157(b)(2)(G) (classifying stay-related motions as "core" proceedings); *see also* Exhibit 1, column (e) (illustrating that a proceeding to enforce a bankruptcy-triggered guaranty must be filed subsequent to the debtor's filing for bankruptcy).

327. *See* 28 U.S.C. § 157(b)(1) (defining "core" proceedings to be proceedings that "arise under" title 11 or "arise in" a case under title 11); *see also id.* § 157(b)(2)(G) (classifying stay-related motions as "core" proceedings).

328. Because the guarantor is keenly aware that the filing of the debtor's bankruptcy petition is the condition triggering the guarantor's own liability, it is in the best interest of the guarantor to file both the motion to modify the automatic stay and the debtor's bankruptcy petition on the same day. *See* Eisenson, *supra* note 1, at 263 (discussing the disincentives a springing guaranty imposes on the guarantor in deciding whether to authorize the debtor's bankruptcy filing, implicitly suggesting that the guarantor is keenly aware of the effect a bankruptcy filing will have on his or her own liability under the guaranty). By doing this, the guarantor may not even realize that he or she is securing an added benefit: the motion to modify the automatic stay raises the springing guaranty issue before the bankruptcy court at the same time that the lender learns of the

Because it is the debtor's filing of a Chapter 11 petition that triggers the guarantor's liability, the lender will never have a cause of action against the guarantor until after the bankruptcy petition has been filed.[329] If the debtor files the guarantor's motion to modify the automatic stay at the same time that the debtor files for bankruptcy, it will be impossible for the lender to file a state court action before the guarantor has submitted the motion.[330] Thus, a guarantor may take advantage of the strict procedural requirements under the doctrine of mandatory abstention and defeat the jurisdictional bar by filing the motion to modify the automatic stay and the bankruptcy petition simultaneously. This will ensure that the guarantor's springing guaranty filing "arises under" the Bankruptcy Code.[331]

In light of the guarantor's and debtor's ability to control the jurisdiction in which the bankruptcy proceeding will take place, the only question left unanswered is whether the debtor will agree to file the

---

debtor's bankruptcy filing and thus the potential to sue the guarantor. *See supra* notes 317-21 and accompanying text. One can assume that the lender first learns of the guarantor's liability on the date of the debtor's bankruptcy filing and thus the provision of notice to all interested parties to the bankruptcy, including the lender. *See* Exhibit 1, column (e). Therefore, the springing guaranty issue is before the bankruptcy court at a time when the guarantor could not have commenced an action in state court, and therefore the guarantor will be unable to meet the requirements for mandatory abstention. *See* 28 U.S.C. § 1334(c)(2).

329. *See Exploding and Springing Guarantees*, *supra* note 55, at 1 (defining a springing guaranty as a guaranty where "the guarantor's liability springs into existence only upon the occurrence of some undesirable event . . . (e.g., the filing of bankruptcy)"); *see also* Exhibit 1, column (e) (illustrating that in 11 our of the 12 cases from my case study, the filing of the springing guaranty case occurred subsequent to the debtor's filing for bankruptcy). The only exception would be where the guarantor becomes liable on the guaranty pursuant to a different enumerated triggering condition unrelated to the subsequent bankruptcy filing. *See* 111 Debt Acquisition LLC v. Six Ventures, Ltd., No. C2-08-768, 2009 WL 414181 (S.D. Ohio Feb. 18, 2009), *aff'd sub nom.*, 111 Debt Acquisition Holdings, LLC v. Six Ventures Ltd., 413 F. App'x 824 (6th Cir. 2011).

330. *See Exploding and Springing Guarantees, supra* note 55, at 1. By employing this tactic, a lender's motion for mandatory abstention will never succeed because the lender will never be able to demonstrate the requirement of the fifth factor that the action be commenced in state court. *See, e.g.*, *In re* Refco, Inc. Sec. Litig., 628 F. Supp. 2d 432, 445 (S.D.N.Y. 2008); *see supra* notes 298-99, 313-14 and accompanying text.

331. 28 U.S.C. § 1334(c)(2); 28 U.S.C. § 157(b)(2)(G).

motion to modify the automatic stay on the guarantor's behalf.[332] Generally, where a loan agreement contains a springing guaranty, the lender ensures that the guarantor has a position of authority within the borrower's company and can exercise his or her authority to bar any subsequent bankruptcy filings.[333] Thus, it is safe to assume that the guarantor who decides whether to authorize a borrower to file for bankruptcy could issue an order to file a motion to modify the automatic stay.[334]

Data collected from twelve springing guaranty cases indicates that a guarantor has the ability to influence a debtor's decision to file a motion on the guarantor's behalf.[335] These cases illuminate three factors

---

332. *See infra* notes 333-35 and accompanying text. *See also* Exhibit 1 (citing the twelve springing guaranty cases that provide the basis for the conclusions reached in Exhibit 2); Exhibit 2 (supporting the conclusion that a springing guarantor has the ability to influence a debtor's decision to file a motion to modify the automatic stay). In agreeing to file the guarantor's motion to modify the automatic stay, the debtor also assumes responsibility to cover the cost of filing that motion. *See* Judicial Conference Comm. on Rules of Practice and Procedure, Bankruptcy Court Miscellaneous Fees, 19 (Dec. 2014) (issued by the Judicial Conference pursuant to 28 U.S.C. § 1930), *available at* http://www.uscourts.gov/FormsAndFees/Fees/BankruptcyCourtMiscellaneousFeeSchedule.aspx. Additionally, it is reasonable to expect that the hours expended by the debtor's attorneys in drafting and litigating the motion to modify the automatic stay will call for additional attorney's fees. *Id.* However, it seems logical that if the debtor was not willing to pay the filing fee, the guarantor would reimburse the debtor the amount of the cost. *Id.*

333. *See* Eisenson, *supra* note 1, at 263 ("By imposing personal liability on a guarantor, which is usually a person in control of the borrower, bad boy guaranties create a financial disincentive for the guarantor to cause, or even permit, the borrower to impede the lender's collateral enforcement action by filing a bankruptcy petition."); *see also Will Exploding Guaranties Bomb?*, *supra* note 4, at 136 ("[A] bankruptcy-contingent guaranty is not, at its core, an obligation of a third party or a contract of financial assurance; it is a bonding device used to control the business decisions of the debtor, with financial liability imposed on the principals as a penalty for breach.").

334. It is safe to assume that the principal in control of the business decisions of the debtor has equal control over the decision to file a petition and the decision to file a motion in the debtor's bankruptcy case. *See Will Exploding Guaranties Bomb, supra* note 4, at 136; *see also* 11 U.S.C. § 362 (providing for the debtor's automatic stay); 28 U.S.C. § 157(b)(2)(G) (conferring core jurisdiction over a motion to modify the automatic stay).

335. *See* Exhibit 1; Exhibit 2. I chose the cases for this case study for several reasons. I wanted a sample that would be representative of the characteristics of the corporate debtor in most springing guaranty cases. The large majority of springing

underlying this influence and a debtor's willingness to assume responsibility for filing the guarantor's motion.[336] The extent of a

guaranty cases involve corporate debtors that share the same trademark characteristics that make them the type of companies that lenders will be most likely to require to include a springing guaranty as part of their loan agreement. These trademark characteristics are: the corporate form these companies choose is usually a Limited Liability Company ("LLC") or a Limited Liability Partnership ("LLP"); they often are single asset real estate cases with only one major secured creditor holding a lien on the property; and they usually are private, as opposed to public, companies. Therefore, this note centers on a twelve-case subset of springing guaranty cases primarily involving borrowers with these characteristics. In addition, I also looked for more recent springing guaranty cases in choosing which cases to include in the case study. The purpose of this was to ascertain how courts view springing guaranties today. However, even if a case fit within the other criterion, I only chose a case for the study if the triggering condition was a bankruptcy-related event (e.g. the debtor's filing a petition in bankruptcy or the lender's collateral becoming an asset in bankruptcy). In conjunction with that, I only chose springing guaranty cases that were concurrent with the debtor's bankruptcy case (e.g. the debtor's simultaneous bankruptcy case had not been dismissed prior to the lender's initiation of the springing guaranty proceeding). My intention in undertaking this case study was to study the relationship between a springing guarantor and the corporate debtor and analyze whether—on the basis of that relationship—the springing guarantor could act through the debtor to file a motion to modify the automatic stay pursuant to § 105 of the Code. The table found in Exhibit 1 is the citations providing the evidence that led me to draw the conclusions I reach on the basis of the answers delineated in Exhibit 2. It should be noted here that Exhibit 3 bears no relation to this case study. *See* Exhibit 1.

336. Exhibit 1 provides a table of the twelve springing guaranty cases that informed this Note's conclusion that springing guarantors will generally be able to persuade debtors to file motions on their behalf. The far left-hand column of the table found in Exhibit 1 includes a case designation for each of the cases. This designation is determined by the guarantor's last name and is included as a shorthand term aimed at facilitating recall of the case names. Each case listing is then comprised of five columns, labeled (a) through (d) from left to right. Column (a) consists of a citation to the bankruptcy docket for the borrower's bankruptcy case. Column (b) consists of a citation to a judgment either determining whether to enforce the springing guaranty or identifying the court with ultimate jurisdiction to decide that issue. Column (c) is a citation to the voluntary petition filed at the outset of the debtor's bankruptcy case. The bullet points in this category are the "Name of Debtor" and "Nature of Business" transcribed from the debtor's petition. The debtor's name is there to illustrate that most springing guarantor debtors adopt some variant of a limited liability corporate form. The debtor's business is there to illustrate that most springing guarantor debtors are single asset real estate companies. Column (d) is a citation to another document filed in the debtor's bankruptcy case: the summary of schedules. The summary of schedules reflects the debtor's financial position as of the time the debtor filed for bankruptcy.

guarantor's control relies on a determination of (A) whether the guarantor(s) acted as the DIP in the debtor's bankruptcy case; (B) whether the guarantor signs as the corporate debtor on the petition; and (C) the role of the guarantor in the debtor's entity.[337] The import of (B) is that a Chapter 11 petition designates the debtor signing thereunder as the individual "authorized to file this petition on behalf of the debtor."[338] The import of (C) is that guarantors holding greater ownership interests and higher managerial positions in the corporate debtor are presumed to be able to exercise relatively more control.[339]

If the guarantor acted as the DIP, signed the petition, retained close to 100% equity ownership of the debtor entity, and held some managerial office within the debtor's corporate structure, then the dataset included in Exhibit 1 assumes that the guarantor had the capacity to exercise a relatively greater degree of control over the debtor.[340] Nine of the twelve cases reveal that the guarantor can exercise substantial control over the debtor's decisions.[341] Three of the twelve cases initially appear to be exceptions: *UBS Commercial Mortgage Trust v. Garrison Special Opportunities Fund L.P*,[342] *GCCFC 2006-GG7 Westheimer Mall, LLC v. Okun*,[343] and *Wells Fargo Bank Minnesota, N.A. v. Kobernick, C.A*.[344] Unlike the other cases, the guarantor in *Garrison* was

337. In analyzing what actor(s) holds decision-making authority over the debtor entity, corporate law governs. The basic principle is that whoever holds the largest single block of shares in the company controls the decisions of the company. Thus, the owner of the company ultimately decides whether to file for bankruptcy and what motions to make once in bankruptcy. Robert K. Rasmussen, *Debtor's Choice: A Menu Approach to Corporate Bankruptcy*, 71 TEX. L. REV. 51, 79 n. 118 (1992) (referencing management's control over the decision of whether or not to file for bankruptcy, as well as the leverage management possesses once in bankruptcy).

338. *See* Exhibit 1, column (c) (citing to the twelve voluntary petitions filed in the case study conducted herein).

339. For each of the cases, Exhibit 2 states the answers to (A), (B), and (C).

340. *See* Exhibit 1.

341. *See* Exhibit 2.

342. UBS Commercial Mortg. Trust v. Garrison Special Opportunities Fund L.P., No. 652412/2010, 2011 WL 4552404 (N.Y. Sup. Ct. Mar. 8, 2011); *see infra* note 345 and accompanying text.

343. GCCFC 2006-GG7 Westheimer Mall, LLC v. Okun, No. 07 CIV. 10394 (NRB), 2008 WL 3891257 (S.D.N.Y. Aug. 21, 2008); *see infra* note 348 and accompanying text.

344. Wells Fargo Bank Minnesota v. Kobernick, C.A. No. 8-CV-1458, 2009 WL 7808949 (S.D. Tex. May 28, 2009), *aff'd sub nom.*, U.S. Bank, Nat'l Ass'n v.

not an individual, but rather a fund: Garrison Special Opportunities Fund LP ("Garrison").[345] Garrison would have had a more difficult time filing its motion to modify the automatic stay because Garrison was not the only owner of the corporate debtor but rather one of several owners and therefore held a correspondingly lower percentage of the overall ownership.[346]

In *Okun*, the guarantor, Edward Okun, only held a 1% equity stake in the corporate debtor.[347] Thus, as guarantor, Okun could be outvoted on the decision of whether to file a motion to modify the automatic stay on his behalf.[348] Nevertheless, there was no question that a bankruptcy court would have jurisdiction to preside over *Okun*. First, Okun controlled the other related borrower entities, which held a 99% equity interest in the corporate debtor.[349] Second, Okun was a co-debtor in the

---

Kobernick, 454 F. App'x 307 (5th Cir. 2011); *see infra* notes 350-54 and accompanying text.

345. *Garrison Special Opportunities Fund L.P.*, 2011 WL 4552404, at *1.

346. *See* Debtor's Corp. Ownership Statement, *In re* Penzance Cascades N., LLC, No. 10-16643 (Bankr. S.D.N.Y. Dec. 15, 2010), ECF No. 1 (listing the seven equity owners of the debtor and their percentage of equity interests held in the debtor, respectively, including Garrison Special Opportunities Fund LP with 61.16% of indirect ownership interests in the Debtor).

347. *See* Debtor's Amended Petition, *In re* IPofA W. Oaks Mall, LP, No. 07-33649-KRH, 2007 WL 3223295 (Bankr. E.D. Va. Oct. 29, 2007), ECF No. 17 (listing Edward H. Okun as the manager of the debtor's general partner); *see also* Debtor's Statement of Fin. Affairs at Question 21, *In re IPofA W. Oaks Mall, LP*, No. 07-33649-KRH, 2007 WL 3223295 (Bankr. E.D. Va. Oct. 29, 2007), ECF No. 106 (providing that the entities with equity interests in the debtor are a general partner with 1% interest and a limited partner with 99% interest).

348. *See* Debtor's Amended Petition, *In re* IPofA W. Oaks Mall, LP, No. 07-33649-KRH, 2007 WL 3223295 (Bankr. E.D. Va. Oct. 29, 2007), ECF No. 17; *see also* Debtor's Statement of Fin. Affairs at Question 21, *In re IPofA W. Oaks Mall, LP*, No. 07-33649-KRH, 2007 WL 3223295 (Bankr. E.D. Va. Oct. 29, 2007), ECF No. 106.

349. In this springing guaranty suit, the district court defined the borrower entities to include IpofA West Oaks Mall, LP, IpofA West Oaks Master LeaseCo, LP and IpofA West Oaks Mall LeaseCo, LP. GCCFC 2006-GG7 Westheimer Mall, LLC v. Okun, No. 07 CIV. 10394(NRB), 2008 WL 3891257, at *1 (S.D.N.Y. Aug. 21, 2008). The court then stated that the guarantor, Edward Okun, owned or controlled all three of the borrower entities. *Id.*; *see also* Complaint at 2, *In re IPofA W. Oaks Mall, LP*, No. 07-33649-KRH, 2007 WL 3223295 (Bankr. E.D. Va. Oct. 29, 2007) (attaching schedules of Okun's interest in all three of the debtor entities as Exhibit A). This allowed Okun to control decisions over the corporate debtor even though his control was not derivative

borrower's bankruptcy case.[350] Okun's status as a debtor meant that his claim arose in the context of a bankruptcy proceeding, giving a bankruptcy court proper jurisdiction without relying on the corporate debtor to file a motion to modify the automatic stay on Okun's behalf.[351] Thus, where the guarantor is a co-debtor with the borrower, the guarantor should propose a reorganization plan seeking to enjoin the enforcement of the springing guaranty pursuant to § 105.[352]

The third exception is the guarantor in *Kobernick*, who appeared to exercise less control over the corporate debtor, Communidad Kensington Club I, LLC ("Communidad").[353] There were three controlling managers of Communidad, but only one of the three—Mitchell Kobernick—faced potential liability as the borrower's guarantor because once Communidad becomes a debtor, the guarantor is automatically liable.[354] Thus, the other two managers would have no incentive to protect Kobernick at their own expense.[355] Nevertheless, Communidad's first proposed plan of reorganization included an attempt to secure a temporary injunction against the lender's suit to enforce the

---

of his status as guarantor. *See* Complaint at 2, *In re IPofA W. Oaks Mall, LP*, No. 07-33649-KRH, 2007 WL 3223295 (Bankr. E.D. Va. Oct. 29, 2007).

350. Docket at 2, *In re IPofA W. Oaks Mall, LP*, No. 07-33649-KRH, 2007 WL 3223295 (Bankr. E.D. Va. Oct. 29, 2007) (listing under "Debtor Information" the names of the debtor parties to the case and including Edward H. Okun as a debtor).

351. *Id.*; *see also* Beslow & Eliason, *supra* note 4, at *4 ("[T]he automatic-stay protections of Section 362 of the Bankruptcy Code . . . do not bar a lender from pursuing a third-party guarantor unless that guarantor has also filed for bankruptcy protection.").

352. Docket at 2, *In re IPofA W. Oaks Mall, LP*, No. 07-33649-KRH, 2007 WL 3223295 (Bankr. E.D. Va. Oct. 29, 2007); *see* 11 U.S.C. § 105(a) (2012) (giving the bankruptcy courts the power to enter necessary or appropriate orders to effectuate the provisions of the Code).

353. *See* Wells Fargo Bank Minnesota v. Kobernick, C.A. 8-cv-1458, 2009 WL 7808949, at *2 (S.D. Tex. May 28, 2009), *aff'd sub nom.*, U.S. Bank, Nat'l Ass'n v. Kobernick, 454 F. App'x 307 (5th Cir. 2011); *see also* Debtor's Plan of Reorganization § 4.05 at 13, *In re* Communidad Kensington Club I, LLC, No. 08-32127-H5-11 (Bankr. S. D. Tex. Jun. 27, 2008), ECF No. 46.

354. *Kobernick*, 2009 WL 7808949, at *2 (explaining that in order for the borrower, Communidad, to be put into bankruptcy, all three of its managers needed to vote unanimously to authorize the filing).

355. *Id.*

springing guaranty.[356] This is indicative of Kobernick's ability to influence the actions of the corporate debtor and supports the inference that Kobernick could have caused Communidad to file a motion to modify the automatic stay on his behalf.[357]

The aforementioned case study reveals that most of the guarantors could have caused the debtors to file the motion to modify the automatic stay simultaneously with the petition.[358]

C. INVOCATION OF § 105 TO BAR ENFORCEMENT OF A SPRINGING GUARANTY

1. The Bankruptcy Code Provisions and their Policies May Support the Use of § 105 to Bar Enforcement of Springing Guaranties

Assuming the bankruptcy court can retain jurisdiction over the springing guaranty issue, this Note argues in favor of the court's issuance of a § 105 injunction to bar the enforcement of springing guaranties.[359] Section 105(a) provides: "[t]he court may issue any order,

---

356. *See* Debtor's Plan of Reorganization § 4.05 at 13, *In re Communidad Kensington Club I, LLC*, No. 08-32127-H5-11 (Bankr. S.D. Tex. Jun. 27, 2008), ECF. No. 46 ("Upon Confirmation of the Plan, the Class 2 Creditor will be temporarily enjoined, pursuant to Section 105 of the Bankruptcy Code, from proceeding against . . . Mitchell Kobernick.").

357. *Id.*

358. *See* Exhibit 2 (illustrating the degree of control each guarantor held over the corporate debtor). In one of the twelve cases, the debtor—Market Center East Retail Property, Inc—did in fact file a § 105 Motion to protect its non-debtor guarantor. *See* Debtor's Motion for Injunction, *In re* Mkt. Ctr. E. Retail Prop., Inc., 1:09-BK-11696, ECF No. 63; *see* Bank of Am. v. Lahave, No. B237360, 2013 WL 1208423 (Cal. Ct. App. Mar. 26, 2013). However, at the time that debtor filed its motion, the lender had already commenced an action to enforce the springing guaranty in state court. *See* Debtor's Motion for Injunction, *In re Mkt. Ctr E. Retail Prop., Inc.*, 1:09-BK-11696, ECF No. 63; *see also Lahave*, 2013 WL 1208423. Although this meant that the guarantor would not be able to rely on a procedural technicality to defeat a mandatory abstention motion outright, the key takeaway is that the debtor filed this motion for the benefit of its guarantor, Danny Lahave. *See* Debtor's Motion for Injunction, *In re Mkt. Ctr E. Retail Prop., Inc.*, 1:09-BK-11696, ECF No. 63; *see also Lahave*, 2013 WL 1208423. This adds further support for the conclusion of the case study—e.g., debtors in springing guaranty cases will be willing to file motions to modify the automatic stay on behalf of their guarantors. *See* Exhibit 1; Exhibit 2.

359. *See* 11 U.S.C. § 105(a) (2012); *supra* note 16 and accompanying text.

process, or judgment that is necessary or appropriate to carry out the provisions of this title[.]"[360] Thus, in order to invoke § 105, the bankruptcy court must rely on another provision of the Code to justify the invocation of its equitable powers.[361] The bankruptcy court could rely on any of the following provisions to justify enjoining the enforcement of a springing guaranty pursuant to § 105: 11 U.S.C. §§ 361, 362, 365(e), 510(c), 541, 1107. Each of these provisions provides the bankruptcy court with a means to invoke § 105 in furtherance of the key policies behind Chapter 11: (1) to facilitate the debtor's fresh start; and (2) to protect all creditors by fairly distributing the debtor's estate pursuant to the absolute priority rule.[362]

First, a bankruptcy court may invoke § 105 in order to provide adequate protection to the other creditors in the bankruptcy case.[363] Enforcement of a springing guaranty by a state court outside of the debtor's bankruptcy case could impair the legitimate third-party interests of creditors within the debtor's bankruptcy case.[364] Because the general practice of courts addressing this issue has been to permit lenders to enforce their prepetition rights under these guarantees, these lenders get more than they would receive as ordinary creditors in the debtor's bankruptcy.[365] This in turn undermines a key purpose of the bankruptcy

---

360. 11 U.S.C. § 105(a).

361. *Id.*; *see also* First Nationwide Bank v. Brookhaven Realty Assocs., 637 N.Y.S.2d 418, 620 (N.Y. App. Div. 1996) (declining to intervene to protect the guarantor where "the policies of providing a debtor with a fresh start and an opportunity to reorganize its finances are not present").

362. *See generally Will Exploding Guaranties Bomb?*, *supra* note 4, at 135 (discussing the possibility of invoking § 105 in the springing guaranty context as a means to effectuating the bankruptcy policies underlying the Code).

363. *See* 11 U.S.C. § 361 (establishing when the bankruptcy court must provide a creditor with adequate protection and what such protection constitutes).

364. *See* Adams, Jr. & Kirkham, *supra* note 1, at 12 (acknowledging that "[i]nsider springing guaranties are probably the largest impediment to borrower bankruptcies").

365. *See* LBUBS 2004-C8 Derek Drive, LLC v. Gerbino, No. 2:13-CV-2264, 2014 WL 2446362 (W.D. La. May 30, 2014); LBCMT 2007-C3 Seminole Trail, LLC v. Sheppard, No. 3:12CV00025, 2013 WL 3009319 (W.D. Va. June 17, 2013); LBCMT 2007-C3 Sterling Retail, LLC v. Sheppard, No. 1:12-CV-470, 2013 WL 2151683 (E.D. Va. May 15, 2013); U.S. Bank Nat'l Ass'n v. Cotta, No. 11-CV-410, 2012 WL 5335999 (S.D. Tex. Oct. 26, 2012); Wells Fargo Bank, Nat'l Ass'n v. Singh, No. H-12-0147, 2012 WL 3186036 (S.D. Tex. Aug. 2, 2012); UBS Commercial Mortg. Trust 2007-FL1 v. Garrison Special Opportunities Fund L.P., No. 652412/2010, 2011 WL 4552404 (N.Y. Sup. Ct. Mar. 8, 2011); Bank of Am. v. Lightstone Holdings, LLC, 938

process: to distribute the assets of the debtor's estate fairly vis-à-vis all creditors, thereby ensuring adequate protection of each creditor's interests.[366] For these reasons, the enforcement of these springing guaranties undermines many of the "core" purposes underlying Chapter 11.[367]

Second, where a suit against the guarantor is in effect a suit against the debtor, the court could equitably enjoin all proceedings against the non-debtor guarantor in order to give meaning to the debtor's automatic stay.[368] In enacting § 362, Congress sought to defer all claims that would upset the operation of the bankruptcy case.[369] This Congressional intent would be frustrated if a court permitted a suit against the guarantor that was in effect a suit against the debtor to proceed.[370] Therefore, where enforcement of the springing guaranty would harm the reorganization prospects of a viable debtor, the purpose underlying § 362 supports the invocation of § 105 to enjoin temporarily enforcement of the guaranty

N.Y.S.2d 225 (N.Y. Sup. Ct. 2011); Monroe Ctr. II Urban Renewal Co., LLC v. Strategic Performance Fund-II, No. C-52-08, 2010 WL 5343317, at *3 (N.J. Super. Ct. App. Div. Dec. 29, 2010); Wells Fargo Bank Minnesota v. Kobernick, No. 8-CV-1458, 2009 WL 7808949 (S.D. Tex. May 28, 2009), *aff'd sub nom.*, U.S. Bank, Nat'l Ass'n v. Kobernick, 454 F. App'x 307 (5th Cir. 2011); GCCFC 2006-GG7 Westheimer Mall, LLC v. Okun, No. 07 CIV. 10394 (NRB), 2008 WL 3891257 (S.D.N.Y. Aug. 21, 2008); First Nationwide Bank v. Brookhaven Realty Assocs., 637 N.Y.S.2d 418 (N.Y. App. Div. 1996) (permitting lenders to seek a deficiency judgment from the guarantor).

366. *See supra* note 364 and accompanying text.

367. *See* Eisenson, *supra* note 1, at 264 (discussing the incentive against filing created by the springing guaranty and the potentially negative impact such a disincentive can have on the debtor's reorganization prospects).

368. *See* 11 U.S.C. § 362 (2012); *see also* Silverstein, *supra* note 52, at 126 (explaining that a bankruptcy court may stay litigation brought against a non-debtor if the suit would distract the non-debtor to an extent likely to impair the debtor's reorganization process because the reorganization effort requires the non-debtor's undivided attention).

369. *See* 11 U.S.C. § 362; *see also* Marshall E. Tracht, *Contractual Bankruptcy Waivers: Reconciling Theory, Practice, and Law*, 82 CORNELL L. REV. 301, 313 (1997) [hereinafter *Contractual Bankruptcy Waivers*] (explaining that the purpose of the automatic stay is to preserve "the firm's ability to conduct an orderly liquidation or reorganization-central goals of bankruptcy law").

370. *See* Beslow & Eliason, *supra* note 4, at *5 (describing the "sham guaranty" defense under state law, whereby the court will dismiss the guaranty case if the borrower and guarantor are the same individuals).

against the non-debtor guarantor.[371] One can even argue that the broader bankruptcy policies of providing the debtor with a fresh start and giving the debtor an opportunity to reorganize its finances support the issuance of a permanent injunction in the springing guaranty context.[372]

Third, a court could invoke § 105 to permit the debtor to reject burdensome contractual obligations, such as those that disincentivize the debtor's reorganization prospects.[373] Section 365(e) permits the DIP to assume or reject any executory contracts or unexpired leases, subject to the bankruptcy court's approval.[374] Ordinarily, courts have limited the applicability of § 365(e) in one of two manners: (1) by only applying it to bar executory contracts and unexpired leases, but not guaranties; or (2) by not letting it invalidate the guaranty vis-à-vis the guarantor if the guaranty is conditioned on the bankruptcy of a person or entity other than the guarantor, for example, if it is conditioned on the debtor's bankruptcy.[375] However, at least one commentator has argued that a court could justify issuance of a temporary injunction to protect a non-

---

371. *See Contractual Bankruptcy Waivers*, *supra* note 369, at 313 (explaining that the automatic stay is put in place to ensure that the corporate debtor has the opportunity to successfully reorganize).

372. One commentator argues that a springing guaranty is not, by its nature, an obligation of a third party, but rather, an obligation of the debtor itself because of the manner in which it functions in practice. *See Will Exploding Guaranties Bomb?*, *supra* note 4, at 135 (arguing that the inappropriate incentives created by a bankruptcy-contingent guaranty support the issuance of a permanent injunction protecting the guarantor as part of the debtor's confirmed plan of reorganization). "A bankruptcy-contingent guaranty . . . is a bonding device used to control the business decisions of the debtor, with liability imposed on the principals as a penalty for breach." *Id.*

373. *See* 11 U.S.C. § 365(e) (invalidating *ipso facto* clauses contingent upon the solvency of the debtor).

374. *See id.* § 365(a) (authorizing the trustee to assume or reject any executory contracts or unexpired leases); *see also id.* § 1107(a) (conferring upon a debtor in possession in Chapter 11 all of the rights, powers and duties of a trustee). An executory contract is a contract where both sides to the contractual agreement have not completed their obligations thereunder, and thus, the debtor can opt to disaffirm any continuing obligations it may have by rejecting the contract. *See id.* § 365(a), Revision Notes and Legislative Reports, at 1978 Acts (defining an executory contract to include a "contract [] on which performance remains due to some extent on both sides").

375. *See* Monroe Ctr II Urban Renewal Co. LLC, C-000052-08, *aff'd by* Monroe Ctr. II Urban Renewal Co., LLC v. Strategic Performance Fund-II, No. C-52-08, 2010 WL 5343317, at *3 (N.J. Super. Ct. App. Div. Dec. 29, 2010) (addressing both arguments and finding in favor of the lender on both arguments).

debtor guarantor on the grounds that the court was effectuating the purposes underlying § 365(e) of the Code.[376] The intended purpose of § 365(e) is to permit the DIP to reject a contractual obligation that is burdensome to the bankruptcy estate and likely to impair the debtor's rehabilitation.[377] Thus, the DIP should be permitted to reject a bankruptcy-contingent guaranty because such a guaranty constitutes "a contract against a third party [that] has the effect of creating additional leverage over the debtor upon the filing of the bankruptcy case[.]"[378]

Fourth, where lenders behave inequitably vis-à-vis other creditors, the court could issue a § 105 injunction to bar the enforcement of an action that would leave that lender with an unfair advantage relative to the position of the other creditors.[379] Section 510(c) permits the bankruptcy court to reorder a creditor's claims.[380] For instance, the court could penalize a creditor who engaged in inequitable conduct by subordinating that creditor's claims to claims of one or more other creditors.[381] The court could even go one step further by ordering the transfer of that creditor's subordinated claim to the estate.[382] This transfer in effect permits a bankruptcy court to disallow a creditor's

376. *See Will Exploding Guaranties Bomb?*, *supra* note 4, at 135.

377. *See* Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, § 365, 92 Stat. 2549, S. REP. 95-989, 59 (justifying the need for § 365(e) of the Code on the ground that ipso facto or bankruptcy clauses frequently hamper the debtor's rehabilitation efforts).

378. *See Will Exploding Guaranties Bomb?*, *supra* note 4, at 135 (describing such a contract as falling within the intended functions of § 365(e)).

379. *See* 11 U.S.C. § 510(c)(1); *see also Exploding and Springing Guarantees*, *supra* note 55, at 2 (discussing the potential invocation of the equitable subordination provision of the Code to subordinate the lender's claim in the borrower's bankruptcy case).

380. *See* 11 U.S.C. § 510(c)(1); *see also Exploding and Springing Guarantees*, *supra* note 55, at 2 (permitting the bankruptcy court to punish a lender who acts in a manner detrimental to the debtor or other creditors in the bankruptcy case by subordinating the lender's claim to the claims of those other claimants).

381. *See* 11 U.S.C. § 510(c)(1) (permitting a court, after notice and a hearing, to "subordinate for purposes of distribution all or part of an allowed claim to all or part of another allowed claim or all or part of an allowed interest to all or part of another allowed interest").

382. *See id.* §510(c)(2) (permitting a court, after notice and a hearing, to "order that any lien securing such a subordinated claim be transferred to the estate").

claim in its entirety.[383] The policy rationale behind § 510(c) is readily applicable to the springing guaranty context.[384] The springing guaranty deters the insider-guarantor from authorizing the borrower's bankruptcy filing to the detriment of all creditors other than the creditor holding the guaranty.[385] This type of unfair advantage adhering to the benefit of a single creditor is exactly the type of wrong Congress sought to redress in providing the bankruptcy court with the power to reorder priorities pursuant to § 510(c).[386]

Fifth, it is appropriate for the court to issue an injunction to protect the assets of the bankruptcy estate.[387] Section 541 of the Code defines property of the estate as all legal or equitable interests of the debtor as of the commencement of the case.[388] One can argue that enforcement of the guaranty and the guarantor's subsequent claim for indemnification from the debtor can impair the debtor's reorganization.[389] The indemnification money would be withdrawn from the debtor's estate, thereby reducing the money available to other creditors.[390] If the guarantor is a co-debtor or the debtor is a co-guarantor, enforcement of the springing guaranty will affect the debtor's bankruptcy estate.[391]

---

383. *Id.*; *see also Exploding and Springing Guarantees*, *supra* note 55, at 2 ("Section 510(c) of the Bankruptcy Code . . . permits the subordination or disallowance of a lender's claim in appropriate circumstances.").

384. *See Exploding and Springing Guarantees*, *supra* note 55, at 2.

385. *See id.* at 2 (citing John C. Murray, *Exploding and Springing Guarantees*, 441 PLI/REAL 301, 308 (May/June 1999)) ("[T]he [§ 510(c)] argument []is that the filing of bankruptcy might have been delayed (perhaps an involuntary bankruptcy ultimately was initiated) to the detriment of the creditors due to the deterrent influence of the exploding or springing guaranty on the borrower's decision makers.").

386. *Id.*; *see* 11 U.S.C. § 510(c); *supra* note 286 and accompanying text.

387. *See* 11 U.S.C. § 541 (defining what constitutes the property of the debtor's bankruptcy estate).

388. *Id.*

389. *See In re* Extended Stay Inc., 418 B.R. 49, 57 (Bankr. S.D.N.Y. 2009), *aff'd in part* 435 B.R. 139 (S.D.N.Y. 2010) (identifying the potential for a guarantor's indemnification claim to affect the property available for distribution to the other creditors of the debtor).

390. *Id.*

391. There is at least one springing guaranty case, where the guarantor was also a named debtor in the borrower's bankruptcy case. GCCFC 2006-GG7 Westheimer Mall, LLC v. Okun, No. 07 CIV. 10394 (NRB), 2008 WL 3891257 (S.D.N.Y. Aug. 21, 2008). There is also at least one springing guaranty case, where both the corporate borrower and the individual insider of the borrower were named guarantors under the

The validity of an indemnification claim is contingent on whether the guaranty agreement included an express right of indemnification, an implicit right of indemnification, or a provision against indemnification.[392] If the loan agreement contains an express provision to indemnify, the debtor will ultimately have to pay the guarantor, causing that money to be withdrawn from the bankruptcy estate.[393] Courts have held that where there is an express indemnification agreement between the debtor and the guarantor, the bankruptcy court has jurisdiction over the proceeding because its outcome unquestionably will affect the debtor's estate in its bankruptcy case.[394] If the loan agreement is silent as to whether or not the debtor has an obligation to indemnify the guarantors, a presumption exists in favor of an implied right of indemnity.[395] Thus, where a loan agreement is silent, there should be a presumption that the indemnification money will be withdrawn from the bankruptcy estate.[396] Although this is the governing substantive law, some courts nonetheless assume that in the absence of an express indemnification provision, there is not a sufficient basis to confer "related to" jurisdiction on the bankruptcy court.[397] However, the

---

guaranty agreement. Guaranty Agreement, Bank of Am., N.A. v. Lightstone Holdings, LLC, No. 601853/09, 2011 WL 4357491 (N.Y. Sup. Ct. July 14, 2011), ECF No.11.

392. *See* Glen Banks, *Contribution and Indemnity*, 28 N.Y. PRAC., CONTRACT L. § 25:22 (arguing that there is no implied obligation on the part of the debtor to indemnify the guarantor if the parties have explicitly provided otherwise in the guaranty agreement).

393. *See In re* Brentano's, Inc., 27 B.R. 90, 92 (Bankr. S.D.N.Y. 1983) (explaining how the outcome of the guaranty agreement relates to the subsequent assertion of an indemnification claim in the debtor's bankruptcy case and consequent determines the fate of the debtor's reorganization effort).

394. *Id.* (finding that the bankruptcy court could exercise "related to" jurisdiction over the non-debtor guaranty proceeding because of the express indemnification agreement between the debtor and the guarantor).

395. *See* Banks, *supra* note 392 ("When a party agrees to become a guarantor at the behest of the principal obligor, there is an implied obligation on the part of the obligor to indemnify the guarantor for whatever performance it needs to render under the guaranty.").

396. *Id.*

397. *See In re* Quigley Co., 676 F.3d 45, 54 (2d Cir. 2012) (distinguishing between a common law right of indemnification, where the non-debtor would have to bring a wholly separate proceeding outside of the debtor's bankruptcy proceeding to recover, and a non-debtor's claim pursuant to a shared insurance policy, where the non-debtor can assert that claim in the debtor's bankruptcy case against the estate).

bankruptcy court would have jurisdiction if the guarantor is covered by an insurance policy paid for by the debtor.[398] If the corporate debtor maintained an insurance policy for its employees, the guarantor would be covered thereunder.[399] On the other hand, if the loan agreement expressly provides that the guarantor has no right to seek indemnity from the debtor, then that money will not be withdrawn from the estate.[400] This makes it more difficult to argue in favor of the bankruptcy court's "related to" jurisdiction over the springing guaranty proceeding.[401] Even where the guaranty agreement includes a provision against indemnification, the enforcement of the springing guaranty would still threaten the estate's assets if the guarantor asserts an equitable subordination claim in the debtor's bankruptcy case.[402]

The bankruptcy court can also invoke its equitable powers if the time and cost associated with the guaranty proceeding would impair the guarantor's ability to manage the debtor's business or bankruptcy case effectively.[403] For instance, in the bankruptcy of Extended Stay, Inc. ("ESI"), ESI filed a Motion to Extend Exclusivity Periods for filing a plan of reorganization.[404] In support of its motion, ESI detailed the correlation between the magnitude and complexity of its bankruptcy

---

398. *See id.* at 55 (citing A.H. Robins Co. v. Piccinin, 788 F.2d 994, 1001–02 (4th Cir. 1986)) (explaining that where the non-debtor third-party and debtor share an insurance policy, that insurance policy nonetheless is considered property of the debtor's estate, and thus, the third-party may assert an insurance claim against the estate to recover the litigation costs that third-party is forced to expend in defending against the guaranty litigation or worse, to recover the full amount that third-party must pay if held liable).

399. *See Piccinin*, 788 F.2d at 1001-02 ("[A]ctions 'related to' the bankruptcy proceedings against . . . officers or employees of the debtor who may be entitled to indemnification under such policy or who qualify as additional insureds [] under the policy are to be stayed under section 362(a)(3).").

400. *See* Banks, *supra* note 392.

401. *Id.*

402. *See* 11 U.S.C. § 510(c) (2012) (providing for the equitable subordination of the claim held by a creditor who acts in an inappropriate manner to gain an unfair advantage over other creditors).

403. *See id.* § 1107 (providing for the current management in Chapter 11 to act as the DIP, thereby retaining control over the debtor's business operation throughout the entirety of the bankruptcy case).

404. Debtor's Motion to Extend Exclusivity Periods, *In re* Extended Stay, Inc., 418 B.R. 49 (Bankr. S.D.N.Y. 2009), *aff'd in part* 435 B.R. 139 (S.D.N.Y. 2010), ECF No. 289.

case and the resulting burden imposed on its managers.[405] ESI was one of several entities within the Extended Stay family of hotels that all simultaneously filed for bankruptcy.[406] Since the same entity managing ESI also managed the other members of the Extended Stay hotel network, the sheer number of debtors greatly exacerbated the toll on management in terms of both time and energy.[407]

In Chapter 11, the debtor's old management continues as the DIP, a role that a trustee would otherwise play in Chapter 7.[408] Thus, the DIP is responsible for compiling all requisite information regarding the debtor's financial condition and timely filing that information in the form of schedules and reports.[409] Where, as in the ESI case, the same management has to complete these obligations for more than one debtor, the resulting burdens can be overwhelming.[410] The DIP must account for the indebtedness of each individual debtor.[411] The greater the amount of that indebtedness, the greater the burden imposed on the DIP.[412] Greater debt levels require the DIP to account for the claims of creditors with diversified interests and to try to align all of those interests in an effort

---

405. *Id.* at 8-9 (Provisions 16-17).

406. *Id.* at 2 (providing that Extended Stay Inc. and its debtor affiliates each commenced a voluntary bankruptcy case on June 15, 2009).

407. *Id.* at 3 (Provision 7) ("All Extended Stay hotels are managed by [HVM].").

408. Section 323 is part of Chapter 3, a generally applicable chapter of the Bankruptcy Code. *See* 11 U.S.C. § 323. Section 323 makes the trustee the representative of the estate. *See id.* § 323(a); *see also* S. REP. No. 95-989, 95th Cong., 2d Sess. 37 (1978). However, in a Chapter 11 case, the debtor in possession becomes the representative of the estate. *See* 11 U.S.C. § 1107(a); *see also* S. REP. No. 95-989, 95th Cong., 2d Sess. 37 (1978).

409. Debtor's Motion to Extend Exclusivity Periods at 8 (Provision 16), *In re Extended Stay, Inc.*, 418 B.R. 49, 57, ECF No. 289 ("Undoubtedly, the filing of voluminous Schedules and 2015.3 Reports requires considerable time and devotion of resources of the Debtors' management and their professionals, particularly given the number of Debtors in these cases.").

410. *Id.* ("Management's first priority has been to focus on the daily operations of the Debtors' hotel business, leaving little time to focus on plan preparation and negotiation.").

411. *Id.* at 8-9 (Provision 17) (detailing the different forms of debt owed by each debtor).

412. *Id.* at 7-8 (Provision 15) (identifying the size and complexity of the debtors' chapter 11 case as the most common basis relied upon by courts in granting a debtor's motion to extend its exclusivity periods).

to confirm a plan of reorganization.[413] Thus, an increase in the number of parties asserting claims in the debtor's bankruptcy case correlates with a greater likelihood of conflicting interests and a correspondingly diminished likelihood of the DIP developing a Chapter 11 plan within the debtor's exclusive periods.[414] The DIP in the ESI bankruptcy cited the number of debtors, creditors, and the $7.4 billion it owed in debt as sufficient grounds to justify the DIP's request for an extension of ESI's exclusivity periods.[415] Since the primary player acting as the DIP is the guarantor, these factors are all indicative of the burden the debtor's bankruptcy imposes upon the guarantor in terms of time and money.[416]

In the springing guaranty case triggered by ESI's filing for bankruptcy, the guarantor was David Lichtenstein, one of ESI's managers and the 100% equity owner.[417] During the relevant period, Lichtenstein was the "President, CEO, and Chairman of ESI."[418] Lichtenstein was also the owner of HVM Manager, an entity with the absolute right to manage and direct the operations of a separate entity, HVM LLC ("HVM").[419] HVM, in turn, is an affiliate of ESI that is responsible for the management of ESI and for the payment of ESI's

---

413. *Id.* at 9-10 (Provisions 18-19) (discussing how "numerous parties potentially having interests in the plan of reorganization and effectively having a seat at the negotiating table" have complicated the debtors' efforts to promote global plan negotiations).

414. *Id.*

415. *Id.* at 8-9 (Provision 17).

416. *Id.*; *see* 11 U.S.C. § 1107 (2012) (explaining that the guarantor is the debtor's management who continues to run the business operations of the debtor throughout the duration of the debtor's bankruptcy as the DIP).

417. Bank of Am. v. Lightstone Holdings, LLC, 938 N.Y.S.2d 225 (N.Y. Sup. Ct. 2011); *see also* Complaint at 5 (Provision 22), Lichtenstein v. Willkie Farr & Gallagher LLP, 992 N.Y.S.2d 242 (N.Y. App. Div. 2014), ECF No. 1 ("Mr. Lichtenstein and representatives of Lichtenstein-related entities comprised a majority of the members of the board of directors of ESI. Thus, the ultimate decision whether ESI was going to file for bankruptcy rested on Lichtenstein.").

418. *See* Complaint at 4 (Provision 16), *Lichtenstein*, 992 N.Y.S.2d 242 (N.Y. App. Div. 2014), ECF No. 1.

419. Disclosure Statement for the Debtors' First Amended Plan of Reorganization Under Chapter 11 of the Bankr. Code, *In re Extended Stay, Inc.*, 418 B.R. 49, ECF No. 796.

post-petition expenses.[420] Importantly, ESI's first plan of reorganization defined the HVM Manager Owner as David Lichtenstein, otherwise known as the debtor's insider-guarantor.[421] Thus, much of the financial obligations and managerial responsibilities attributed to HVM in the debtor's Motion to Extend Exclusivity Periods can be attributed to Lichtenstein in his individual capacity.[422] ESI describes the role of HVM as the manager of the debtor's business operations in the following manner:

> HVM, on behalf of Extended Stay, pays all property level expenses of the hotels, contracts with service providers and purchases all goods and materials utilized in the operation of the business. HVM employs approximately 9,200 employees in connection with the operation of the hotels at any given point in time.[423]

ESI, HVM, and the Extended Stay family of hotels are responsible for operating over 680 hotels.[424] ESI's bankruptcy forced the debtors and HVM to expend a substantial amount of time and energy toward ensuring the smooth operation of the debtor's business while in bankruptcy.[425] ESI explained in its exclusivity extension request that managing the daily operations of the debtors' hotel business consumed much of its management's time, "leaving little time to focus on plan preparation and negotiation."[426] In sum, Lichtenstein was the individual controlling HVM.[427] HVM was the entity tasked with managing ESI.[428]

---

420. Statement of Fin. Affairs for Extended Stay Inc., *In re Extended Stay, Inc.*, 418 B.R. 49, ECF No. 454. HVM's responsibility is to manage all of the Extended Stay hotels. *Id.* However, the Extended Stay companies do not own HVM. *Id.*

421. Debtor's Plan of Reorganization Under Chapter 11 of the Bankr. Code, *In re Extended Stay, Inc.*, 418 B.R. 49, ECF No. 769.

422. *See supra* text accompanying notes 405-17.

423. Debtor's Motion to Extend Exclusivity Periods, *In re Extended Stay, Inc.*, 418 B.R. 49, ECF No. 289.

424. *Id.*

425. *Id.*

426. *Id.*

427. Disclosure Statement for the Debtors' First Amended Plan of Reorganization Under Chapter 11 of the Bankr. Code, *In re Extended Stay, Inc.*, 418 B.R. 49, ECF No. 796.

428. Statement of Fin. Affairs for Extended Stay Inc., *In re Extended Stay, Inc.*, 418 B.R. 49, ECF No. 454. HVM's responsibility is to manage all of the Extended Stay hotels. *Id.* However, the Extended Stay companies do not own HVM. *Id.*

Therefore, Lichtenstein – through HVM – had to cope with the burdens tangential to ESI's decision to enter Chapter 11.[429] These burdens included: navigating the debtor's complex capital structure, responding to information requests submitted by a myriad of parties, balancing the conflicting interests of those parties, consolidating debtor-related litigations commenced in distinct jurisdictions, and conducting investigations of appointed personnel, such as examiners and special servicers.[430]

Consequently, Lichtenstein and other insider-guarantors were forced to cope with the ordinary obligations associated with the debtor's filing and to exhaust substantial resources in an effort to avoid being held personally liable pursuant to the springing guaranty.[431] The imposition of these simultaneous burdens on the guarantor necessarily detracted from the guarantor's ability to focus on the debtor's bankruptcy, which in turn had a detrimental effect on the debtor's bankruptcy case.[432]

2. Why a Bankruptcy Court is Justified in Invoking its Equitable Powers Pursuant to § 105

a. Temporary v. Permanent Injunctions

As a preliminary matter, when a party moves for the issuance of a § 105 injunction, a bankruptcy court can respond in several ways including: declining to issue the injunction, issuing a temporary injunction, or issuing a permanent injunction.[433] Temporary injunctions are effective up until the point at which the debtor's plan has been confirmed in the bankruptcy.[434] Permanent injunctions require the

---

429. Debtor's Motion to Extend Exclusivity Periods, *In re Extended Stay, Inc.*, 418 B.R. 49, ECF No. 289.

430. *Id.*

431. *See* Debtor's Plan of Reorganization Under Chapter 11 of the Bankr. Code, *In re Extended Stay, Inc.*, 418 B.R. 49, ECF No. 769 (explaining that David Lichtenstein is the owner of HVM Manager LLC, which manages HVM LLC, which in turn manages the daily operations of the debtor).

432. *Id.*; *see also* Adams, Jr. & Kirkham, *supra* note 1 (describing the burdensome responsibilities of the DIP in the debtor's bankruptcy case).

433. *See Will Exploding Guaranties Bomb?*, *supra* note 4, at 135.

434. *Id.*

proponent of such an injunction to make a showing of exceptional circumstances.[435] Some bankruptcy courts will not even entertain the possibility of a permanent injunction because they read § 524 to place an outright bar on the issuance of a permanent injunction.[436] Other bankruptcy courts are willing to overlook § 524 in exceptional cases, but these courts nonetheless classify a permanent injunction as an extraordinary form of relief.[437]

b. Section 105 Temporary Injunctions

i. The Five-Factor Test: When to Issue an Injunction Pursuant to § 105

The disincentives created by the springing guaranty lead to delayed filing and harm to the debtor's viable reorganization, and thus, bankruptcy courts are justified in invoking their equitable powers to enjoin enforcement of such guaranties.[438] Bankruptcy courts are split over whether they can invoke their § 105 equitable powers to confirm a reorganization plan providing for the release of certain non-debtor liabilities pursuant to the plan.[439] In addition, the circuits that do permit non-debtor releases apply different tests in assessing whether the facts of a given case are sufficient to warrant the invocation of § 105.[440] Nevertheless, there are five factors that courts are most likely to rely upon in making their determination.[441]

---

435. *Id.* at 136.

436. *Id.* at 135.

437. *Id.* at 135-36.

438. *See supra* note 39 and accompanying text (explaining the connection between the springing guaranty device, the debtor's delayed bankruptcy filing, and the harm to the debtor's reorganization prospects that results from the delay); s*ee also* 11 U.S.C. § 105 (2012); *supra* note 16 and accompanying text.

439. Silverstein, *supra* note 52, at 44.

440. *Id.* at 64 ("While pro-release courts generally agree upon the source of their authority to issue non-debtor releases, they differ in critical respects over the circumstances in which such authority may be exercised.").

441. *Id.* at 64-66.

1. Identity of Interests

First, "there must be an identity of interest between the debtor and the third party" such that a suit against the non-debtor in effect constitutes a suit against the debtor.[442] The most common basis for finding the existence of an identity of interest is where enforcement against the non-debtor results in the non-debtor holding a contribution, indemnification, or equitable subrogation claim against the debtor.[443] In general, courts find an identity of interest to exist where the suit against the non-debtor will ultimately lead to the depletion of the estate's assets.[444] Thus, in the springing guaranty context, the application of this factor should extend to the pre-filing context, as well as the post-filing context.[445] The inclusion of a springing guaranty in the borrower's loan documents inevitably will result in the pre-filing depletion of assets that would otherwise have been included in the debtor's estate.[446] The springing guaranty causes the guarantor to delay the debtor's filing for bankruptcy in the hopes that by taking desperate measures, such as trying to sell off assets, the guarantor can avoid having to file.[447] However, this strategy rarely succeeds.[448] Instead, the guarantor's delay tactic depletes the company's assets from the time the guarantor first should have filed until the time the guarantor actually does file.[449] Thus, at the time the guarantor files, the company's financial condition is severely impaired as a result of the perverse incentives the springing guaranty creates for the guarantor in deciding whether to file.[450] Additionally, it is highly probable that a previously entered state court

---

442. *Id.*

443. *Id.* at 65.

444. Silverstein, *supra* note 52, at 65.

445. *Id.* at 64-65.

446. *See infra* notes 486-503 and accompanying text.

447. *See Guaranties in Bankruptcy*, *supra* note 216 (discussing the factors courts consider to justify the issuance of a § 105(a) injunction).

448. *Id.*

449. *See In re* Extended Stay, Inc., 418 B.R. 49 (Bankr. S.D.N.Y. 2009), *aff'd in part* 435 B.R. 139 (S.D.N.Y. 2010) (indicating that in the six months prior to ESI's bankruptcy filing, its total assets dropped from $7.1 billion to $13 million).

450. *See supra* note 372 and accompanying text.

order already liquidated the lender's claim.[451] This would occur if the lender pursues its springing guaranty action in state court, and the state court then enters a judgment against the guarantor.[452] This scenario potentially precludes the bankruptcy court from restructuring the lender's debt so as to benefit the bankruptcy estate, the debtor, and all the creditors.[453] To achieve such a restructuring, the bankruptcy court would need to preclude the lender from recovering the fully accelerated amount of the loan.[454] However, the state court presiding over the springing guaranty proceeding likely already permitted the lender to enforce the loan up to its entire accelerated amount.[455] Thus, the state court's enforcement of the springing guaranty ends up removing the bankruptcy court's usual discretion to restructure the terms of the loan in a manner that facilitates, rather than hinders, the debtor's reorganization.[456]

2. Contribute "Substantial" Assets

Second, "the third party must contribute 'substantial' assets to the reorganization"—i.e. contribute "large sums of money to the estate for distribution to creditors and/or [] release [] claims the non-debtor possesses against the debtor."[457] As a result of the close interrelation between the guarantor and the debtor in springing guaranty cases, it is almost inevitable the guarantor will hold a contribution, indemnification, or subrogation claim against the debtor.[458] The close connection between

---

451. *See* Exhibit 3, columns (a), (c) (providing examples of state courts that entered judgment in favor of the lender in the amount specified under the terms of the springing guaranty).
452. *Id.*
453. *Id.*
454. *Id.*
455. *Id.*
456. *See* Exhibit 3, columns (a), (c).
457. Silverstein, *supra* note 52, at 65.
458. *See, e.g.*, Pfizer Inc. v. Law Offices of Peter G. Angelos (*In re* Quigley Co.), 676 F.3d 45, 53 (2d Cir. 2012), *cert. denied*, 133 S. Ct. 2849 (U.S. 2013) (identifying situations where the guarantor holds an indemnification claim against the debtor); *see* A.H. Robins Co. v. Piccinin, 788 F.2d 994, 1001–02 (4th Cir. 1986) (recognizing the guarantor's right to exercise an insurance claim pursuant to an insurance policy owned by the debtor); *Guaranties in Bankruptcy*, *supra* note 216, at 1 ("Generally... the guarantor may rely on its common law rights of subrogation, contribution and

the springing guarantor and the debtor makes it much harder for the debtor to decline to reimburse its managing insider for the entire amount the insider paid as the debtor's guarantor.[459] In this type of personal relationship, the desire of the debtor to pay back its guarantor is likely to exist, regardless of the bankruptcy court's holding with respect to the enforceability of the guarantor's claim against the debtor.[460] In addition, because the guarantor controls the borrower, it is probable that the guarantor and the borrower will reach an agreement without a court order.[461] In this scenario, a guarantor with knowledge of the law may

---

reimbursement to seek payment from the principal obligor for any amounts the guarantor pays under a guaranty."); *see also* 11 U.S.C. § 509 (2012) (providing for the subrogation of certain claims of co-debtors); *id.* § 502 (providing guarantor with the right to assert a claim for reimbursement or contribution).

459. *See* Exhibit 2 (illustrating the close relationship between corporate debtors and their springing guarantors).

460. *Id.* For example, in the bankruptcy of Extended Stay Inc., the debtor asked the bankruptcy court to approve of an order creating a $5 million litigation trust to be paid from the assets of the debtor for the sole benefit of its guarantor, David Lichtenstein, in defending against the springing guaranty proceedings. *See* Debtors' Motion for Order (A) (i) Authorizing Use of Cash Collateral, (ii) Granting Adequate Protection, And (iii) Modifying the Automatic Stay *and* (B) Scheduling a Final Hearing Pursuant to Bankr. Rule 4001 at 41 (Provision 11), *In re* Extended Stay, Inc., 418 B.R. 49 (Bankr. S.D.N.Y. 2009), *aff'd in part* 435 B.R. 139 (S.D.N.Y. 2010), ECF No. 8 ("[The Debtors' Cash Collateral] Budget shall make provision for a litigation reserve in the amount of $5 million [] to be provided to David Lichtenstein for use in defending claims arising out of his authorizing the filing of these Chapter 11 Cases that may be brought against him under certain Guaranties."). Responding to this request, one creditor argued that "[a]ny liability that David Lichtenstein may have under the guaranty should not be funded from assets of the Debtors themselves. Payments in respect of this obligation should not be pork-barreled into a motion for the use of cash collateral." Objection of Five Mile Capital II SPE ESH LLC to Debtors' Motion for Order (A)(i) Authorizing Use of Cash Collateral, (ii) Granting Adequate Protection and (iii) Modifying the Automatic Stay, and (B) Scheduling a Final Hearing Pursuant to Bankr. Rule 4001 at 3, provision (4)(a), *In re Extended Stay, Inc.*, 418 B.R. 49, ECF No. 27.

461. In the *Okun* bankruptcy case, the lender filed a motion referencing this type of out-of-court workout between the debtor entities and the guarantors. GCCFC 2006-GG7 Westheimer Mall, LLC Complaint, E. The Agreement, *In re* IPofA W. Oaks Mall, LP, 3:07-BK-33649 (No. 29) (Bankr. E.D. Va. Oct. 22, 2007). The lender argues that the intent of the arrangement was to benefit the guarantors to the detriment of the other creditors in the bankruptcy case. *Id.* After explaining to the Bankruptcy Court why the workout undermined the priority rule, the lender pointedly remarks that "[n]o request

choose to release his or her contribution, indemnification, or subrogation claims against the debtor.[462] By releasing those claims, the guarantor can satisfy this second factor.[463]

3. Essential to the Reorganization

Third,

> the release must be "essential to the reorganization. Without the release, there is little likelihood of success." To illustrate, in the absence of a release, non-debtors may refuse to contribute assets to the estate that are necessary for the debtor's reorganization. Without the payments, the debtor will be forced to liquidate, which means that creditors will likely recover much less, if they recover at all, and the debtor will not be able to resume its business.[464]

The guarantor is the central insider of the debtor.[465] If the guarantor is facing the threat of personal liability for millions of dollars at the outset of the debtor's bankruptcy case, the guarantor will be forced to divert attention from his or her duties as the DIP.[466] The guarantor will have no choice but to redirect his or her attention to defending against the litigation the guarantor faces individually.[467] Where the guaranty is enforced, the financial devastation that ensues will make it highly unlikely that the guarantor will be in a position to contribute the financing needed to support a confirmable plan of reorganization.[468] For example, in the bankruptcy of Market Center East Retail, Inc., the debtor's first proposed plan of reorganization provided that to the extent any deficiency remains, "the debtor's equity owner, Danny Lahave, will contribute such additional funds, or pledge such additional collateral as may be required to obtain loans, to provide for full and timely payment

---

has been made to [the Bankruptcy] Court for authorization to enter into and/or approval of the Agreement." *Id.*

462. *Id.*

463. Silverstein, *supra* note 52, at 65.

464. *Id.*

465. *See supra* note 333 and accompanying text.

466. Debtor's Motion to Extend Exclusivity Periods, *In re Extended Stay, Inc.*, 418 B.R. 49, ECF No. 289.

467. *Id.*

468. *See* Exhibit 3, column (c) (providing a list of courts that held guarantors liable for millions of dollars pursuant to a springing guaranty).

of all claims allowed under the plan."[469] There, Danny Lahave was also the guarantor under the springing guaranty agreement.[470]

4. Agreement by Substantial Majority of Creditors

Fourth, "a substantial majority of the creditors agree to [the release], specifically, the impacted class, or classes has 'overwhelmingly' voted to accept the proposed plan treatment."[471] This analysis is very difficult to apply in the context of smaller, private companies with often only one key piece of property and one major secured creditor who holds the guaranty.[472]

5. Payment of Claims Held by Impacted Class

Fifth, "the plan provides for 'payment of all, or substantially all, of the claims of the class or classes affected by the' non-debtor release."[473] Ironically, in many of these cases, the secured lender holding the guaranty does not even bother to file a proof of claim in the borrower's bankruptcy case because of the potential to sue based on the guarantor's recourse liability.[474] This undermines the non-recourse nature of a secured loan, insomuch as the lender should have to first file a claim in the bankruptcy case up to the value of the property.[475] In addition, in those cases where the debtor is able to propose a plan prior to the

469. *See* Debtor's First Plan of Reorganization at Article VII, *In re* Mkt. Ctr. E. Retail Prop., Inc., 1:09-BK-11696 (Bankr. D.N.M. June 17, 2009), ECF No. 23; *see also* Bank of Am. v. Lahave, No. B237360, 2013 WL 1208423 (Cal. Ct. App. Mar. 26, 2013) (discussing the enforceability of a late fee in connection with the lender's springing guaranty case against Danny Lahave, the guarantor).

470. *See* Debtor's First Plan of Reorganization at Article VII, *In re* Mkt. Ctr., 1:09-BK-11696; *see also Lahave*, 2013 WL 1208423.

471. Silverstein, *supra* note 52, at 65 (citing *In re* Master Mortg. Inv. Fund, Inc., 168 B.R. 930 (Bankr. W.D. Mo. 1994)).

472. Lenders are most likely to include springing guaranty provisions in the loan documents of this type of creditor. *See supra* note 5 and accompanying text.

473. Silverstein, *supra* note 52, at 66.

474. *But see* GCCFC 2006-GG7 Westheimer Mall, LLC v. Okun, No. 07 CIV. 10394 (NRB), 2008 WL 3891257 (S.D.N.Y. Aug. 21, 2008) (obtaining deficiency judgment against the guarantor, despite also having filed a proof of claim in the debtor's bankruptcy case).

475. *See supra* text accompany notes 44-45.

lender's lawsuit to enforce the guaranty, the debtor's plan *does* provide for full payment to that secured lender, albeit over a more extended period of time.[476] Despite this provision, courts continue to permit the lender to sue the guarantor in the hopes of receiving their payment pursuant to the loan in a timelier manner.[477]

ii. The Five-Factor Test: Application in the Springing Guaranty Context

The very nature of a springing guaranty renders it highly probable that the debtor will be able to satisfy all five factors, with the only potential exception being the fifth factor.[478] The springing guaranty device is a means by which lenders target a specific class of borrowers.[479] Usually, these borrowers are smaller companies with a single or small number of controlling stakeholders.[480] Lenders require those few individuals in control to be the springing guarantor because those are the same people who would ordinarily decide, on the borrower's behalf, whether to authorize a bankruptcy filing.[481] By implication, then, the intent of the lender in requiring a springing guaranty in the loan documents is to create a mechanism by which to deter the guarantor from subsequently authorizing the borrower's filing.[482] Thus, if one takes into account the impact on the bankruptcy of

---

476. *See* JPMCC 2007-C1 Grasslawn Lodging, LLC v. Dix, No. CV-11-00017-TUC-CKJ, 2013 WL 1340039, at *3 (D. Ariz. Apr. 1, 2013) ("[P]ursuant to the Borrower's plan . . . the Plaintiff's claim will be paid in full by the Borrowers.").

477. *See supra* note 281 and accompanying text.

478. *See* Silverstein, *supra* note 52, at 64-66 (describing the test applied by a majority of pro-release courts). The fifth factor is the factor requiring the impacted class of creditors to vote overwhelmingly in favor of the debtor's reorganization plan. *Id.* at 66.

479. Tracht identifies the prevalence of springing guaranties in three contexts. *See Will Exploding Guaranties Bomb?*, *supra* note 4, at 130. "First, they may be used in financing for closely-held businesses, where a single or small number of shareholders, members, or partners own and control the borrower. Second, they are used in commercial real estate lending. Third, they are increasingly common as an adjunct to creating "bankruptcy remote entities in securitized financing transactions." *Id.*

480. *Id.*

481. *See* Eisenson, *supra* note 1, at 263 ("By imposing personal liability on a guarantor, which is usually a person in control of the borrower, bad boy guaranties create a financial disincentive for the guarantor to cause, or even permit, the borrower to impede the lender's collateral enforcement action by filing a bankruptcy petition.").

482. *See id.*

the guarantor's pre-filing decisions, the following appropriately applies the factors.[483]

1. Application: Identity of Interest

First, there is an identity of interest between the debtor and the guarantor because the guarantor's actions during the pre-filing period lead to a direct depletion of the debtor's assets, which upon filing constitute the property of the estate.[484] For example, ESI included in its filings its total assets in December 2008 and its total assets as of May 31, 2009, immediately preceding ESI's filing on June 15, 2009.[485] This information indicated that in the six months prior to filing, ESI's total assets dropped from approximately $7.1 *billion* to $13 *million*.[486] In effect, this reduced the debtor's estate from $7.1 billion to $13 million.[487] In turn, this would reduce what creditors would ultimately recover in ESI's bankruptcy.[488] In this particular case, the insider-guarantor was well aware that if he authorized the borrower's

483. *See* Silverstein, *supra* note 52, at 64-65.

484. *Id.* at 64.

485. Declaration of Joseph Teichman Pursuant to Rule 1007-2 of the Local Bankr. Rules for the S. Dist. of New York in Support of First-Day Motions and Applications ¶ 7 at 3, *In re* Extended Stay, Inc., No. 09-13764 (Bankr. S.D.N.Y. Sept. 28, 2009) (noting that ESI's consolidated assets as of December 31, 2008 were 7.1 billion); Schedules of Assets and Liabs. for Extended Stay Inc. at 3); *see also* Schedules of Assets and Liabilities, at 3, *In re* Extended Stay Inc., 1:09-BK-13764 (2009), ECF Doc. No. 314 (noting that asset presentation is as of May 31, 2009); Summary of Schedules, at 12, *In re* Extended Stay Inc., 1:09-BK-13764 (2009), ECF Doc. No. 314 (listing ESI's total assets as $12,904,854.76).

486. Declaration of Joseph Teichman Pursuant to Rule 1007-2 of the Local Bankr. Rules for the S. Dist. of New York in Support of First-Day Motions and Applications ¶ 7 at 3, *In re Extended Stay, Inc.*, No. 09-13764 (noting that ESI's consolidated assets as of December 31, 2008 were 7.1 billion); Summary of Schedules, *In re Extended Stay Inc.*, No. 09-13764 (listing ESI's total assets as $12,904,854.76).

487. Declaration of Joseph Teichman Pursuant to Rule 1007-2 of the Local Bankr. Rules for the S. Dist. of New York in Support of First-Day Motions and Applications ¶ 7 at 3, *In re Extended Stay, Inc.*, No. 09-13764; Summary of Schedules, *In re Extended Stay Inc.*, No. 09-13764.

488. Declaration of Joseph Teichman Pursuant to Rule 1007-2 of the Local Bankr. Rules for the S. District of New York in Support of First-Day Motions and Applications ¶ 7 at 3, *In re Extended Stay, Inc.*, No. 09-13764; Summary of Schedules, *In re Extended Stay Inc.*, No. 09-13764.

bankruptcy filing, he would also subject himself to up to $100 million in recourse liability.[489] Therefore, this drastic decline in the value of ESI's assets was likely the result of the insider-guarantor's selling off ESI's assets in a desperate attempt to save the company and avoid being held personally liable pursuant to the springing guaranty.[490] Were this the case, the conclusion to be drawn would be that the insider delayed filing beyond the point at which he first should have filed, and when he finally did authorize the filing, the company's reorganization prospects were substantially lower than they otherwise would have been.[491]

When a company's debt increases on its balance sheet, this may indicate that the insider is taking out more debt to try to save the company.[492] In a bankruptcy case that led to personal liability for the corporate debtor's insider-guarantor under the springing guaranty, the debtor's filings with the bankruptcy court indicated that its primary liability was a mortgage in the amount of $1,600,000.[493] Notably, this liability was incurred within ninety days of the corporate debtor's filing on December 29, 2011.[494] As of that filing date, the corporate debtor recorded its total liabilities as $1,636,046.[495] Thus, the close proximity of the date the insider took out the property's mortgage with the date the insider ultimately authorized the bankruptcy filing suggests that the insider was trying to save the company.[496] Presumably, the insider believed taking out the mortgage would enable him to avoid filing and triggering his personal liability as the guarantor.[497] This seems to have

---

489. Complaint at 3 (Provision 14), Lichtenstein v. Willkie Farr & Gallagher LLP, 992 N.Y.S.2d 242 (N.Y. App. Div. 2014), ECF No. 1 ("The Guarantees provided for $100,000,000 personal liability against Mr. Lichtenstein and Lightstone Holdings to the Lenders in the event of particular "bad boy" acts, including the voluntary filing of a bankruptcy petition by ESI.").

490. *See id.*

491. *See id.*

492. Summary of Schedules at 3, *In re* G. Singh Enters., LLC, No. 11-40889 (Bankr. S.D. Tex. Dec. 29, 2011).

493. *Id.* at 12.

494. *Id.* at 20.

495. *Id.* at 4.

496. *Id.* at 12, 20 (showing that the mortgage is the largest liability in the debtor's bankruptcy case).

497. Summary of Schedules at 12, 20, *In re* G. Singh Enters., LLC, No. 11-40889 (Bankr. S.D. Tex. Dec. 29, 2011).

been a final effort by the guarantor that failed, thereby forcing the guarantor to file anyway.[498]

Similarly, the springing guaranty in another bankruptcy case effectively incentivized the debtor's majority owner to delay filing.[499] There, the debtor's total assets mysteriously declined from $9,054,169 at the end of 2010 to $5,360,813.54 as of December 19, 2011, the date of the debtor's bankruptcy filing.[500] Again, it is probable that the insider was trying to sell off corporate assets in order to keep the company running, albeit even if on a smaller scale.[501] Faced with the threat of considerable personal liability upon filing, these springing guarantors resort to alternative remedies to try to avoid filing a bankruptcy petition.[502] The aforementioned examples help to illustrate the detrimental effect a springing guaranty can have on the borrower's subsequent Chapter 11 viability.[503]

2. Application: Contribute "Substantial" Assets

Second, the guarantor's willingness to contribute substantial assets to the reorganization would, for the most part, not be contingent upon the pre-filing decisions of the guarantor.[504] However, in taking out additional debt as part of the guarantor's efforts to save the company,

---

498. *Id.* at 3.

499. *See* Summary of Schedules, *In re* Cotta Prop. Mgmt., LLC, No. 11-20706 (Bankr. S.D. Tex. Aug. 9, 2012). Tax Return (Form 1065), *In re* Cotta, No. 11-20706 (Bankr. S.D. Tex. Dec. 5, 2011), ECF 1-1 (stating total assets in 2010 were just over $9 million).

500. Summary of Schedules, *In re* Cotta, No. 11-20706 (Bankr. S.D. Tex. Aug. 9, 2012).

501. *See id.*

502. *See* Adams, Jr. & Kirkham, *supra* note 1, at 7 (discussing the manner in which these guaranties deter borrowers from filing for bankruptcy and incentivize guarantors to put their personal interests ahead of the interests of the rest of their partners, the firm itself, and its creditors).

503. *See Pursuit of the Guarantor*, *supra* note 47 (discussing reasons justifying a court's issuance of a § 105 injunction in similar situations where the debtor seeks to protect its non-debtor guarantor); *see also Guaranties in Bankruptcy*, *supra* note 216 (discussing the limited case law that does exist on the enforceability of springing guaranties). As a result of the limited case law that is specifically on-point to the springing guaranty context, it is necessary to consider the factors courts apply in similar guaranty cases in determining whether to issue a §105 injunction. *Id.*

504. *See Guaranties in Bankruptcy*, *supra* note 216, at 65.

the guarantor likely makes loans to the debtor in his or her individual capacity, through another company controlled by the guarantor, or a combination of the two.[505] This means the non-debtor—whether it be the guarantor or the guarantor's other company—would then hold claims against the debtor's estate.[506] Thus, if the guarantor individually released those claims or caused his other corporate entity to do so, he would be deemed to be contributing "substantial assets to the reorganization," thereby satisfying factor two of the five-factor test.[507]

3. Application: Essential to the Reorganization

Third, the inherent nature of a springing guaranty reduces the likelihood of the debtor undergoing a successful reorganization.[508] A per se rule prohibiting enforcement of these springing guaranties or treating the lender's claim as disallowed pursuant to § 510(c) would likely illustrate why such a release is essential to the debtor's reorganization.[509] Without the guarantor's financially ruinous behavior in the months leading up to the bankruptcy filing, the debtor's finances would not position the company to end up in Chapter 7 after a few months, as is often the case.[510] Instead, those finances would reflect a viable company that filed for bankruptcy at the right time, and thereby avoided the detrimental effect of the erratic decisions of a desperate guarantor.

The springing guaranty not only negatively impacts the debtor's financial resources before the debtor has even filed, but also has a negative impact during the bankruptcy case.[511] Because springing guaranties are only effective if the guarantor is in a position to dictate whether the borrower will ultimately file a bankruptcy petition, the

505. *Id.*; *see also* Schedules of Assets & Liabs. (Schedule F) at n.1, *In re* Extended Stay, Inc., 1:09-BK-13764 (No. 314) (noting that sixteen days prior to the borrower's petition filing, the amount owed to HVM, an entity controlled by the guarantor, was approximately $36 million).

506. *See Guaranties in Bankruptcy*, *supra* note 215; *see also* Schedules of Assets & Liabs. (Schedule F) at n.1, *In re* Extended Stay, Inc., 1:09-BK-13764 (No. 314).

507. Silverstein, *supra* note 52, at 65.

508. *Id.*

509. *Id.*; *see also* 11 U.S.C. § 510(c) (2012) (providing for the equitable subordination of an overreaching lender's claim).

510. *See infra* accompany text notes 512, 525.

511. *See infra* accompany text notes 562-65.

guarantor almost always holds a controlling stake in the borrower.[512] Thus, it is this guarantor who stands to lose if the borrower must convert to Chapter 7 and liquidate.[513] Therefore, it is in the guarantor's best interest to ensure the debtor can present a confirmable Chapter 11 plan.[514] In order to achieve plan confirmation, the guarantor must reassure creditors that the debtor can meet its obligations pursuant to the plan by promising to provide the debtor with substantial loans if necessary.[515] Further, the guarantor is most likely the debtor's source of pre-filing loans.[516] Therefore, the guarantor will hold claims in the debtor's bankruptcy case that the guarantor may need to forfeit in order to enable the debtor to achieve plan confirmation.[517] Consequently, the guarantor will both contribute substantial finances in the form of loans to the estate and release claims the guarantor holds against the estate.[518]

4. Application: Agreement by Substantial Majority of Creditors

The fourth factor would not depend on the guarantor's pre-filing decisions.[519] Instead, it is the factor most dependent upon how many other creditors are in the debtor's bankruptcy case, what class they belong to, and what their respective claims are.[520] This will be the

---

512. *See* Eisenson, *supra* note 1, at 263 (equating a springing guarantor with a person in control of the borrower).

513. *Id.* As a controlling stakeholder, the guarantor will lose the value of his or her investment in the borrower if the borrower must liquidate, as opposed to successfully reorganizing, exiting Chapter 11, and operating profitably. *See Exploding and Springing Guarantees*, *supra* note 55, at 1 (explaining that the springing guarantor is usually the person in control of the debtor).

514. *See id.*

515. *See supra* notes 47-50 and accompanying text.

516. *See* Debtor's Motion Pursuant to § 1121(d) of the Bankr. Code Requesting Extension of Exclusive Periods for the Filing of a Chapter 11 Plan and Solicitation of Acceptances Thereof, *In re* Extended Stay Inc., No. 09-13764 (Bankr. S.D.N.Y. Sept. 15, 2009) (noting that HVM, the corporate entity controlled by the guarantor and managing the debtor, held several claims for outstanding debts in the debtor's bankruptcy case).

517. *See id.*

518. *See* Adams, Jr. & Kirkham, *supra* note 1, at 12-13 (discussing both the risk of liability of insiders on springing guaranties, as well as the burdens imposed on the debtor in possession in Chapter 11).

519. Silverstein, *supra* note 52, at 65-66.

520. *Id.*

hardest factor for the debtor to establish because – as applied in the springing guaranty context – it will be examining whether the impacted class of creditors (e.g. the lender holding the springing guaranty) votes overwhelmingly in favor of the debtor's reorganization plan.[521]

5. Application: Payment of Claims Held by Impacted Class

Finally, there is a specific type of borrower that leads lenders to include springing guaranties in the loan documents.[522] Lenders do not want borrowers with certain characteristics—predominantly single asset real estate companies that have assumed some variation of a limited liability corporate form—to file for bankruptcy because of the threat such a filing poses to the lender.[523] Thus, the large majority of springing guaranty cases involves corporate debtors that share these same trademark characteristics, subjecting them to an increased likelihood that a lender will require their loan agreement to include a springing guaranty provision.[524] Of the twelve case studies, eleven ultimately resulted in an insider of the corporate debtor being held personally liable pursuant to a springing guaranty.[525] Of the twelve corporate debtors in those cases, ten assumed some variation of a limited liability corporate form, whether it was an LLC, LTD, or LP.[526] Similarly, nine out of the twelve checked the box for "Single Asset Real Estate" as the nature of their business on their bankruptcy petitions and correspondingly listed

---

521. *See id.* at 64-66.

522. *Id.*

523. *See Will Exploding Guaranties Bomb?*, *supra* note 4, at *130 (describing the three contexts, where lenders are most likely to require a bankruptcy-contingent guaranty); *see also* Adams, Jr. & Kirkham, *supra* note 1, at 2 (discussing the connection between single asset real estate entities and the tendency to include springing guaranties in their commercial real estate loan documents); Douglas K. Moll, *Minority Oppression and the Limited Liability Company: Learning (or Not) from Close Corporation History*, 40 WAKE FOREST L. REV. 883, 883 (2005) (explaining that most closely held businesses are structured as LLCs).

524. *See supra* note 523 and accompanying text.

525. *See* Exhibit 1 (listing the twelve cases utilized in the case study); *see also* Exhibit 3, column (c) (stating the holding in those twelve springing guaranty proceedings, among others). *But see* Bank of Am. v. Lahave, No. B237360, 2013 WL 1208423 (Cal. Ct. App. Mar. 26, 2013) (barring the lender from collecting a five percent late fee from the guarantor).

526. *See* Exhibit 1, column (c).

only one piece of real property on Schedule A; the remaining three checked "other."[527] All but one debtor indicated that its creditors were within the one through forty-nine range, indicating that these were smaller companies with proportionally lesser degrees of debt.[528] However, only one debtor qualified as a small business debtor.[529] Finally, all twelve debtors were private, non-listed companies.[530]

The conclusion here for purposes of applying factor five is that lenders include springing guaranty provisions in the loan documents of small single-asset real estate companies that only have one major secured creditor in their subsequent bankruptcy cases.[531] That creditor holds the springing guaranty.[532] As such, the debtor's plan inevitably will provide for payment to the secured creditor comprising the "class affected by the non-debtor release" because that creditor is usually the only secured creditor in the debtor's bankruptcy case.[533]

Therefore, the absence of the deterrent effect on the guarantor's pre-filing decision-making and the subsequent absence of the profusion of the guarantor's unwise pre-filing decisions would lead to the debtor entering bankruptcy in an improved financial state.[534] This in turn makes it all the more likely that the debtor would have the capacity to present a plan that could satisfy the fifth factor.[535]

---

527. *Id.*

528. *Id. But see* Voluntary Petition, *In re* Six Ventures, Ltd., No. 2:08-bk-58468 (Bankr. S.D. Ohio Sept. 3, 2008) (listing its creditors as within the "50-99" range).

529. *See* Exhibit 1, column (c). *But see In re* G. Singh Enters., LLC, No. 11-40889 (Bankr. S.D. Tex. Dec. 29, 2011) (qualifying as a small business debtor).

530. *See* Bloomberg Terminal. This latter characteristic presents a problem in terms of finding the company's pre-filing financial data for the purpose of assessing how the guarantor's delay in filing the bankruptcy petition impacts the company's financial condition. *Id.* However, some financial information about the corporate debtor in the aforementioned cases can be gleaned from the schedules that the corporate debtor is required to file in a bankruptcy court. *See* Exhibit 1, column (d) (providing the citation to the summary of schedules filed by each debtor in the case study in their bankruptcy case).

531. *See* Exhibit 1, column (d) (providing the citation to the summary of schedules filed by each debtor in the case study in their bankruptcy case); Silverstein, *supra* note 52, at 64-66.

532. *See* Exhibit 1, columns (b), (d).

533. Silverstein, *supra* note 52, at 66.

534. *Id.* at 66.

535. *Id.*

c. Section 105 Permanent Injunctions

In order to justify the issuance of a permanent injunction to protect a non-debtor guarantor, the debtor's proposed plan must show that the guarantor will be instrumental in contributing financing or assets to the debtor throughout the reorganization process.[536] In the alternative, the debtor could show in its plan that the guarantor plays such a key and unique role in running the debtor's business that enforcement against the guarantor would detract from his ability to manage the debtor's operations.[537] The debtor would then need to show how the guarantor's managerial absence would cause a severe impairment to the debtor's reorganization process.[538] Essentially, the guarantor must be one of the people injecting money in some form into the debtor during its reorganization or be one of a very small number of people with the requisite knowledge to navigate effectively the complexities of the debtor's business.[539] The latter scenario means that if the guarantor were absent from the reorganization, there would be no one else or very few others who could fill the guarantor's shoes in managing the debtor's business.[540]

Despite the stringent standard bankruptcy courts apply in determining whether to issue a permanent injunction, there is still a strong argument for the issuance of a permanent injunction to bar the enforcement of a springing guaranty.[541] A springing guaranty is not merely an obligation to a third party, rather, it is a way for a lender directly to "control the business decisions of the debtor"—for example, the decision whether or not to initiate a bankruptcy proceeding.[542] This is precisely why the borrower's controlling insiders are selected to be the guarantors.[543] Lenders assume that these guarantors are in a position to bar the debtor's bankruptcy filing because their goal is to bankruptcy-

---

536. *See Pursuit of the Guarantor*, *supra* note 47, at 1.
537. *Id.*
538. *Id.*
539. *Id.*
540. *Id.*
541. *Will Exploding Guarantees Bomb?*, *supra* note 4, at 135.
542. *Id.*
543. *See supra* note 333 and accompanying text.

proof the loan documents.[544] Thus, in an appropriate case, a bankruptcy court should issue a permanent injunction pursuant to § 105 discharging the liability under the springing guaranty as part of the debtor's confirmed plan of reorganization.[545]

d. Per Se Rule v. Case-by-Case Approach

The degree of financial harm that befalls the debtor as a result of the springing guarantor's pre-filing decisions will vary depending on the unique facts of each case.[546] Thus, an issue that could arise in the future would be whether a court tasked with determining the enforceability of a springing guaranty triggered by a bankruptcy filing should apply a per se rule or a case-by-case approach.[547] Unfortunately, the springing guaranty context is not one that permits a case-by-case approach.[548] Were that the rule, a guarantor would be unsure of his own potential liability during the duration of the pre-filing period, and, as such, he would inevitably employ the strategy of selling off assets and increasing his debt in an effort to keep the company afloat, and if that fails, he

544. *See* Adams, Jr. & Kirkham, *supra* note 1 (explaining that the most important part of a springing guaranty for a lender facing a potential borrower bankruptcy is that it triggers the guarantor's liability for the full amount of the loan if the borrower files for bankruptcy and thus deters some borrowers from resorting to bankruptcy).

545. *Will Exploding Guaranties Bomb?*, *supra* note 4, at 135.

546. Declaration of Joseph Teichman Pursuant to Rule 1007-2 of the Local Bankr. Rules for the S. Dist. of New York in Support of First-Day Motions and Applications ¶ 7 at 3, *In re* Extended Stay, Inc., No. 09-13764 (Bankr. S.D.N.Y. Sept. 28, 2009) (noting that ESI's consolidated assets as of December 31, 2008 were 7.1 billion); Schedules of Assets and Liabs. for Extended Stay Inc. at 3, *In re Extended Stay, Inc.*, No. 09-13764 (noting that asset presentation is as of May 31, 2009); Summary of Schedules, *In re Extended Stay, Inc.*, No. 09-13764 (listing ESI's total assets as $12,904,854.76); Summary of Schedules at 12, *In re* G. Singh Enters., LLC, No. 11-40889, at 4, 12, 20 (Bankr. S.D. Tex. Dec. 29, 2011) (establishing that the debtor's total liabilities consisted almost entirely of a mortgage taken out within 90 days of the debtor's bankruptcy filing); Summary of Schedules, *In re* Cotta Prop. Mgmt., LLC, No. 11-20706 (Bankr. S.D. Tex. Aug. 9, 2012) (revealing the almost four million dollar decrease in the debtor's total assets in the year prior to the debtor's filing).

547. *See Contractual Bankruptcy Waivers*, *supra* note 369, at 303 (discussing the enforceability of bankruptcy waivers in general and advocating for a case-by-case approach, as opposed to a per se rule deeming such waivers to be enforceable).

548. *See id.* at 313; *supra* notes 486-503 and accompanying text.

would authorize the filing.[549] However, at that point, the guarantor's pre-filing decisions have already transformed what would have otherwise been a company ripe to undergo a successful reorganization into a company tiptoeing the line between Chapter 11 and Chapter 7.[550]

In light of the aforementioned issues, it is likely that some form of per se rule would be necessary to resolve the filing disincentive problem that is created by the springing guaranty.[551] Even if it is necessary to apply a per se rule in the context of springing guaranties, there are still ways that bankruptcy courts could limit this rule's application so that it does not result in the issuance of unwarranted permanent injunctions.[552] One way would be to limit the applicability of the per se rule to temporary injunctions.[553] This would allow bankruptcy courts to adopt a case-by-case approach in subsequently deciding whether to issue a permanent injunction.[554] In the alternative, a bankruptcy court could apply the per se rule in the context of both temporary and permanent injunctions, but limit its applicability to specific types of cases in which the per se rule would apply.[555] For instance, a court could provide that this per se rule will not apply in cases where the guarantor's delayed

549. *See supra* notes 486-503 and accompanying text.

550. *See supra* notes 486-503 and accompany text; Declaration of Joseph Teichman Pursuant to Rule 1007-2 of the Local Bankr. Rules for the S. Dist. of New York in Support of First-Day Motions and Applications ¶ 7 at 3, *In re Extended Stay, Inc*., No. 09-13764 (noting that ESI's consolidated assets as of December 31, 2008 were 7.1 billion); Schedules of Assets and Liabs. for Extended Stay Inc., at 3 (noting that asset presentation is as of May 31, 2009); Summary of Schedules, *In re Extended Stay Inc.* (listing ESI's total assets as $12,904,854.76); Summary of Schedules at 12, *In re G. Singh Enters., LLC*, No. 11-40889, at 4, 12, 20 (establishing that the debtor's total liabilities consisted almost entirely of a mortgage taken out within 90 days of the debtor's bankruptcy filing); Summary of Schedules, *In re Cotta*, No. 11-20706 (revealing the almost four million dollar decrease in the debtor's total assets in the year prior to the debtor's filing).

551. *See supra* notes 486-503 and accompanying text.

552. *See infra* notes 553–66 and accompanying text.

553. *See Will Exploding Guaranties Bomb?*, *supra* note 4, at 135.

554. *Id.*; *see also Contractual Bankruptcy Waivers*, *supra* note 369, at 314 ("And although a bankruptcy court may not permanently relieve a nondebtor of its liabilities absent extraordinary circumstances, it is interesting to ponder whether some bankruptcy judges might view a bankruptcy-triggered guaranty as just such an extraordinary circumstance.").

555. *See Will Exploding Guaranties Bomb?*, *supra* note 4, at 135 (distinguishing between the issuance of temporary versus permanent injunctions).

filing did not affect the outcome of the debtor's bankruptcy case.[556] As applied, the court would look at the debtor's financial condition at the point in time when the guarantor should have first authorized the bankruptcy filing.[557] If, at that time, the debtor still would not have had any real prospect of undergoing a successful reorganization, then the per se rule would not apply.[558] Therefore, the court would decline to issue an injunction.[559] Another condition on the applicability of the per se rule could be that the rule would not apply in cases where there were no other creditors in a position to be harmed by the enforcement of the springing guaranty.[560]

Finally, the timing of the lender's suit vis-à-vis the borrower's bankruptcy case could also be relevant.[561] For instance, in *Dix*, were the

---

556. *See Exploding and Springing Guarantees*, *supra* note 55, at 2 (discussing the deterrent effect of springing guaranties).

557. *Id.* (explaining the potential for the filing of bankruptcy to be delayed "to the detriment of the creditors due to the deterrent influence of the exploding or springing guaranty on the borrower's decisionmakers").

558. The doctrine of equitable subordination is invoked where the lender engages in conduct that results in a detriment to the debtor or the debtor's creditors. *See id.* at 2. This occurs if the guarantor's delayed filing of the debtor's bankruptcy petition is to the detriment of the debtor or the debtor's creditors. *See id.* However, if—regardless of the delay—the debtor is in such poor financial shape that the debtor will not be able to undergo a successful reorganization anyway, then the delayed filing by the guarantor is not to the detriment of the debtor or the debtor's creditors. *See id.* In this latter scenario, the bankruptcy policy arguments underlying the issuance of a § 105 injunction for the purpose of protecting the guarantor to enable that guarantor to effectively oversee the debtor's reorganization effort are virtually eliminated. *See id.*

559. *Id.*

560. One commentator distinguishes the holdings of the courts in two earlier springing guaranty cases by noting that in each of those cases, the borrower's bankruptcy case had already been dismissed, and thus, there was not a strong bankruptcy policy argument to be made. *Will Exploding Guaranties Bomb?*, *supra* note 4, at 130-31 (citing FDIC v. Prince George Corp., 58 F.3d 1041 (4th Cir. 1995); First Nationwide Bank v. Brookhaven Realty Assocs., 637 N.Y.S.2d 418 (N.Y. App. Div. 1996)).

561. *See* Adams, Jr. & Kirkham, *supra* note 1 (describing all of the obligations of the DIP during the debtor's bankruptcy and the risk of liability of insiders on springing guaranties). The implication is that it would be unfeasible for the guarantor to try to run the debtor's reorganization as DIP, while simultaneously being subjected to tremendous liability under their guaranty obligations to creditors. *Id.* This is why the concurrence of the debtor's bankruptcy case and the springing guaranty case would provide additional support for the issuance of a § 105 injunction. *Id.*

lenders to bring their guaranty suit at the initiation of the debtor's bankruptcy as opposed to after the bankruptcy court had already confirmed the debtor's plan of reorganization, it is probable that the bankruptcy case would have concluded in the same manner as almost every other springing guaranty case triggered by the corporate debtor's bankruptcy filing—dismissal or conversion to Chapter 7.[562] The reason for this is that where the guaranty suit is brought at the start, the distraction of this suit causes the guarantor to ignore his or her obligations as the DIP in order to expend time and money defending against the guaranty suit.[563] If the guarantor loses, then the DIP loans largely disappear.[564] Thus, the toll of the guaranty suit on the DIP results in the DIP failing to perform its obligations in the debtor's bankruptcy case: (1) the DIP does not have the time to maximize profit effectively;

562. JPMCC 2007-C1 Grasslawn Lodging, LLC v. Dix, No. CV-11-00017-TUC-CKJ, 2013 WL 1340039, at *7 (D. Ariz. Apr. 1, 2013); *see also In re* Transwest Resort Props., Inc., 4:10-BK-37134 (2010) (providing timeline of the major events in the debtor's bankruptcy case). In many springing guaranty cases triggered by bankruptcy-related events, the bankruptcy court never enters an order confirming the debtor's Chapter 11 plan of reorganization because the case is dismissed or converted before confirmation. Motion of the United States Trustee to Convert Case to Chapter 7, *In re* Cotta Prop. Mgmt., LLC, 2:11-BK-20706 (No. 80); United States Trustee's Motion to Dismiss, *In re* G. Singh Enters., LLC, No. 11-40889 (Bankr. S.D. Tex. Feb. 19, 2012) (No. 33); United States Trustee's Motion to Dismiss, *In re* Six Ventures, Ltd., No. 08-58468 (Bankr. S.D. Ohio Nov. 10, 2008) (No. 127); United States Trustee's Motion to Dismiss, *In re* Monroe Ctr. II Urban Renewal Co., 2:08-BK-32556 (No. 41,). In *Cotta*, *Singh*, and *Six Ventures*, the bankruptcy courts granted the trustees' requested motions. Motion of the United States Trustee to Convert Case to Chapter 7, *In re Cotta*, 2:11-BK-20706 (No. 80); United States Trustee's Motion to Dismiss, *In re Singh*, No. 11-40889 (No. 33); United States Trustee's Motion to Dismiss, *In re Six Ventures*, No. 08-58468 (No. 127). *But see* Chapter 7 Trustee's Final Report, *In re* Monroe Ctr. II Urban Renewal Co., 2:08-BK-32556 (No. 171) (mooting the trustee's motion to dismiss the case and instead entering a court order converting the case from Chapter 11 to Chapter 7).

563. *See Adams and Kirkham, supra* note 2 (discussing the usual burdens imposed on the debtor in possession in Chapter 11, as well as the role of insider springing guaranties as "the largest impediment to borrower bankruptcies").

564. *See* Debtor's Plan of Reorganization at Provision 4.04, *In re* Communidad Kensington Club I, LLC, No. 08-32127 (Bankr. S.D. Tex. June 27, 2008) (No. 46); Debtor's Plan of Reorganization at Article VII, *In re* Mkt. Ctr. E. Retail Prop. Inc., No. 09-11696-s11 (Bankr. D.N.M. May 6, 2009) (No. 23) (authorizing the debtor to borrow funds from the guarantor to the extent necessary to carry out the debtor's obligations pursuant to its plan of reorganization).

(2) the DIP does not provide the bankruptcy attorney with the necessary information to get the requisite filings in on time, precluding the ability of all parties to assess the financial condition of the company and formulate a viable plan of reorganization; and (3) in the event the guarantor is held liable, the DIP financing largely disappears.[565] However, if the lenders do not file suit for breach of guaranty until after a bankruptcy court has confirmed the debtor's plan of reorganization, the potential harm to the debtor's bankruptcy case is *de minimis* because in effect, that bankruptcy case has already concluded.[566] In that context, the bankruptcy court could cite the status of the bankruptcy case at the time the lenders filed the springing guaranty lawsuit in support of its decision to decline to apply the per se rule.[567]

CONCLUSION

This Note reaches a procedural conclusion and a substantive conclusion with respect to the treatment of springing guaranties triggered by bankruptcy-related events.[568] Procedurally, it is appropriate for a bankruptcy court to exercise jurisdiction over these springing guaranty proceedings.[569] As a result of the interrelatedness between a lender's claim against the guarantor and the guarantor's subsequent claim against the debtor's bankruptcy estate, the initial springing

---

565. *See Adams and Kirkham*, *supra* note 2 (discussing the usual burdens imposed on the debtor in possession in Chapter 11, as well as the role of insider springing guaranties as "the largest impediment to borrower bankruptcies"); *see also supra* notes 49-50, 466-67, 512-14 and accompanying text.

566. *See Will Exploding Guaranties Bomb*, *supra* note 4, at 131 (explaining that where the bankruptcy proceeding is dismissed prior to the initiation of the springing guaranty suit, the guarantor will be precluded from making the same strong bankruptcy policy argument that the guarantor could have made had the lender brought suit on the springing guaranty at the beginning of the debtor's bankruptcy case) (citing FDIC v. Prince George Corp., 58 F.3d 1041 (4th Cir. 1995); First Nationwide Bank v. Brookhaven Realty Assocs., 637 N.Y.S.2d 418 (N.Y. App. Div. 1996)).

567. *See Will Exploding Guaranties Bomb?*, *supra* note 4, at 131 (explaining that the bankruptcy policies of "providing the debtor with a fresh state and an opportunity to reorganize its finances" are largely nonexistent where "the bankruptcy case [is] dismissed prior to the state law suit seeking to impose personal liability").

568. *See supra* Part III.

569. *See supra* Parts III.A, III.B.

guaranty proceeding is "related to" the debtor's bankruptcy case.[570] Even if a bankruptcy court could not exercise "related to" jurisdiction over a springing guaranty proceeding, the proceeding is nonetheless a "core" proceeding because it necessarily "arises in" the debtor's bankruptcy case.[571] Absent the debtor's bankruptcy filing or the lender's collateral becoming an asset in the debtor's bankruptcy, there is no default under the strict terms of the guaranty agreement.[572] Consequently, a bankruptcy court has jurisdiction to preside over springing guaranty proceedings triggered by bankruptcy-related events.[573]

The substantive conclusion is that a bankruptcy court should rely on its equitable powers pursuant to § 105 to enjoin enforcement of springing guaranties if the subject guaranty ultimately harms the debtor.[574] Although a number of bankruptcy policies are in conflict with the lender's rationale for including a springing guaranty in a loan agreement, perhaps the strongest policy argument against the enforcement of these guaranties is grounded in the conflict of interest that they create.[575] A guarantor must choose between what is in his or her own best interest and what is in the best interests of creditors when deciding whether to file for bankruptcy.[576] Lenders ensure that the guarantor who is liable pursuant to these guaranties is the person who is most likely to decide when and whether the borrower should file for bankruptcy.[577] Thus, a springing guaranty influences the decision-maker before deciding whether to file for bankruptcy, thereby compromising not only the interests of other likely parties to the bankruptcy but also the bankruptcy itself.[578] The springing guaranty compels the insider-

570. 28 U.S.C. § 1334 (2012); *id.* § 157.

571. *Id.* § 1334; *id.* § 157. For further discussion, *see supra* Part III.A.

572. *See supra* Part III.A.

573. *See supra* Parts III.A, III.B.

574. *See supra* Part III.C; *see also* 11 U.S.C. § 105(a) (affording a bankruptcy court the power to effectuate the policies of the Code in an equitable manner).

575. *See Will Exploding Guaranties Bomb?*, *supra* note 4, at 135 (discussing the potential invocation of § 105 to enjoin enforcement against the springing guarantor by reference to the policies underlying various sections of the Code); *id.* at 132. (describing the conflict of interest such guaranties create for the guarantor in deciding whether to authorize a bankruptcy filing).

576. *Id.* at 132.

577. *See supra* note 333 and accompanying text.

578. *See supra* note 368 and accompanying text.

guarantor to act in his or her own best interest rather than in the best interest of the firm and its creditors.[579] As a result, the guarantor seeks to delay the impending filing, thereby costing the firm more money in the process, rather than choosing the course of action most likely to yield profits to the firm's creditors—authorizing an immediate filing in Chapter 11.[580] Therefore, bankruptcy courts should invoke their equitable powers in furtherance of the primary goal of Chapter 11: to facilitate the successful rehabilitation of a corporate debtor.[581] If courts continue to enforce these springing guaranties, lenders will continue to include them in loan documents.[582] As a result, corporate borrowers in a position to gain by undergoing the Chapter 11 restructuring process will fail altogether to file or fail to file in a timely manner and thus not realize this potential gain.[583]

579. *See Will Exploding Guaranties Bomb?*, *supra* note 4, at 132 (describing how the springing guaranty creates a conflict of interest between the guarantor's personal best interest and the guarantor's fiduciary duty to the borrower's creditors).

580. *See supra* note 39 and accompanying text.

581. *See supra* Part III.C; 11 U.S.C. § 105(a) (2012).

582. *See Will Exploding Guaranties Bomb?*, *supra* note 4, at 135 (noting that "springing guaranties violate fundamental bankruptcy policies [including] preventing firms that would benefit from reorganization from filing").

583. *Id.*

EXHIBIT 1
CASE STUDY

Guarantor's Last Name	(a) Bankruptcy Docket Citation	(b) Springing Guaranty Judgment Citation	(c) Debtor's Bankruptcy Petition Citation	(d) Summary of Schedules filed in Debtor's Bankruptcy Case Citation	(e) Interim Time Between Petition and Filing of Springing Guaranty Case
(1) Lichtenstein	*In re* Extended Stay, Inc., 1:09-BK-13764	Bank of Am., N.A. v. Lightstone Holdings, LLC, 938 N.Y.S.2d 225 (N.Y. Sup. Ct. 2011)	Voluntary Petition, *In re* Extended Stay, Inc., 1:09-bk-13764 (Bankr. S.D.N.Y. Jun. 15, 2009) Name of Debtor: Extended Stay **Inc.** Nature of Business: Other	Summary of Schedules, *In re* Extended Stay Inc. (listing ESI's total assets as $12,904,854.76).	1 DAY
(2) Cotta	*In re* Cotta Prop. Mgmt., LLC, 2:11-BK-20706	U.S. Bank Nat'l Ass'n v. Cotta, No. 11-CV-410, 2012 WL 5335999 (S.D. Tex. Oct. 26, 2012)	Voluntary Petition, *In re* Cotta Prop. Mgmt, LLC, No. 11-20706 (Bankr. S.D. Tex. Dec. 5, 2011) Name of Debtor: Cotta Property Management, **LLC** Nature of Business: Single Asset Real Estate	Summary of Schedules, *In re* Cotta Prop. Mgmt., LLC, No. 11-20706 (Bankr. S.D. Tex. Aug. 9, 2012).	24 DAYS
(3) Singh	*In re* G. Singh Enters., LLC, 4:11-BK-40889	Wells Fargo Bank, Nat'l Ass'n v. Singh, No. CIV.A. H-12-0147, 2012 WL 3186036 (S.D. Tex. Aug. 2, 2012)	Voluntary Petition, *In re* G. Singh Enters., LLC, No. 11-40889 (Bankr. S.D. Tex. Dec. 29, 2011) Name of Debtor: G Singh Enterprises **LLC** Nature of Business: Other	Summary of Schedules at 18, *In re* G. Singh Enters., LLC, No. 11-40889 (Bankr. S.D. Tex. Dec. 29, 2011)	19 DAYS

(4) Kobernick	*In re* Communidad Kensington Club I, LLC, 4:08-BK-32127	Wells Fargo Bank Minn., N.A. v. Kobernick, No. C.A. 8-CV-1458, 2009 WL 7808949 (S.D. Tex. May 28, 2009) *aff'd sub nom U.S. Bank, Nat'l Ass'n v. Kobernick*, 454 F. App'x 307 (5th Cir. 2011)	Voluntary Petition, *In re* Communidad Kensington Club I, LLC, No. 08-32127 (Bankr. S.D. Tex. June 27, 2008) Name of Debtor: Comunidad Kensington Club I, **LLC** Nature of Business: Single Asset Real Estate	Summary of Schedules, *In re* Communidad Kensington Club I, LLC, No. 08-32127 (Bankr. S.D. Tex. June 27, 2008)	39 DAYS
(5) Perlmutter and Stark	*In re* South Side House, LLC, 1:09-BK-43576	*In re* S. Side House, LLC, 470 B.R. 659 (Bankr. E.D.N.Y. 2012)	Voluntary Petition, *In re* S. Side House, LLC, No. 1-09-43576-ess (Bankr. E.D.N.Y. Apr. 30, 2009) Name of Debtor: South Side House **LLC** Nature of Business: Single Asset Real Estate	Summary of Schedules, *In re* S. Side House, LLC, No. 1-09-43576-ess (Bankr. E.D.N.Y. Apr. 30, 2009)	JUST OVER TWO YEARS
(6) Rhodehamel, Kahn, and McMenamy, Jr.	*In re* Six Ventures, Ltd., *2:08-BK-58468*	111 Debt Acquisition LLC v. Six Ventures, Ltd., No. C2-08-768, 2009 WL 414181 (S.D. Ohio Feb. 18, 2009) *aff'd sub nom. 111 Debt Acquisition Holdings, LLC v. Six Ventures Ltd.*, 413 F. App'x 824 (6th Cir. 2011)	Voluntary Petition, *In re* Six Ventures, Ltd., No. 2:08-bk-58468 (Bankr. S.D. Ohio Sept. 3, 2008) Name of Debtor: Six Ventures, **Ltd.** Nature of Business: Other	Summary of Schedules, *In re* Six Ventures, Ltd., No. 08-58468 (Bankr. S.D. Ohio Sept. 18, 2008)	SPRINGING GUARANTY CASE FILED on the basis of a different triggering condition in the loan documents PRIOR TO DEBTOR'S BANKRUPTCY FILING
(7) Lahave	*In re* Market Ctr. East Retail Prop., Inc., 1:09-BK-11696	Bank of Am. v. Lahave, No. B237360, 2013 WL 1208423 (Cal. Ct. App. Mar. 26, 2013), *reh'g denied* (Apr. 16, 2013), *review denied,* (June 12, 2013)	Voluntary Petition, *In re* Market Ctr. East Retail Prop., Inc., 1:09-bk-11696 (Bankr. D. New Mexico Apr. 22, 2009) Name of Debtor: Market Center East Retail Property, **Inc.** Nature of Business: Single Asset Real Estate	Summary of Schedules, *In re* Market Ctr. East Retail Prop., Inc., No. 09-11696-nlj11 (Bankr. D.N.M. May 6, 2009)	44 DAYS

(8) Gerbino	*In re* Lake Charles Retail Dev., LLC, 1:13-BK-44093	LBUBS 2004-C8 Derek Drive, LLC v. Gerbino, No. 2:13-CV-2264, 2014 WL 2446362 (W.D. La. May 30, 2014)	Voluntary Petition, *In re* Lake Charles Retail Dev., LLC, No. 1-13-44093-nhl (Bankr. E.D.N.Y. July 1, 2013) Name of Debtor: Lake Charles Retail Development **LLC** Nature of Business: Single Asset Real Estate	Summary of Schedules, *In re* Lake Charles Retail Dev., LLC, No. 1-13-44093-nhl (Bankr. E.D.N.Y. July 1, 2013)	14 DAYS
(9) Hoda and Saddel	*In re* Monroe Ctr. II Urban Renewal Co., 2:08-BK-32556	Monroe Ctr. II Urban Renewal Co. v. Strategic Performance Fund-II, No. C-52-08, 2010 WL 5343317, at *3 (N.J. Super. Ct. App. Div. Dec. 29, 2010)	Voluntary Petition, *In re* Monroe Ctr. II Urban Renewal Company, LLC, No. 08-32556-DHS (Bankr. D.N.J. Nov. 14, 2008) Name of Debtor: Monroe Center II Urban Renewal Company, **LLC** Nature of Business: Other	Summary of Schedules, *In re* Monroe Ctr. II Urban Renewal Co., No. 08-32556-DHS (Bankr. D.N.J. Dec. 1, 2008)	JUST OVER TWO YEARS
(10) Okun	*In re* IPofA West Oaks Mall, LP,, 3:07-BK-33649	GCCFC 2006-GG7 Westheimer Mall, LLC v. Okun, No. 07 CIV. 10394 (NRB), 2008 WL 3891257 (S.D.N.Y. Aug. 21, 2008)	Voluntary Petition, *In re* IPofA West Oaks Mall, LP, No. 07-33649-KRH (Bankr. E.D. Va. Oct. 2, 2007) Name of Debtor: IPofA West Oaks Mall, **LP** Nature of Business: Single Asset Real Estate	Summary of Schedules, *In re* IPofA West Oaks Mall, LP, No. 33649-KRH (Bankr. E.D. Va. Dec. 19, 2007)	45 DAYS
(11) Garrison	*In re* Penzance Cascades North, LLC, 1:10-BK-16643	UBS Commercial Mort. Trust 2007-FL1 v. Garrison Special Opportunities Fund L.P., 938 N.Y.S.2d 230 (Sup. Ct. 2011)	Voluntary Petition, *In re* Penzance Cascades North, LLC, No. 10-16643-reg (Bankr. S.D. Tex. Dec. 15, 2010) Name of Debtor: Penzance Cascades North, **LLC** Nature of Business: Single Asset Real Estate	Summary of Schedules, *In re* Penzance Cascades North, LLC, et al., No. 10-16643 (Bankr. S.D.N.Y. Feb. 14, 2011)	14 DAYS
(12) Sheppard and Wolman	*In re* WSG Charlottesville, LLC, 12-12785-BFK	LBCMT 2007-C3 Seminole Trail, LLC v. Sheppard, No. 3:12CV00025, 2013 WL 3009319 (W.D. Va. June 17, 2013)	Voluntary Petition, *In re* WSG Charlottesville, LLC, No. 12-012785-BFK (Bankr. E.D. Va. May 1, 2012) Name of Debtor: WSG Charlottesville, **LLC** Nature of Business: Single Asset Real Estate	Summary of Schedules, *In re* WSG Charlottesville, LLC, No. 12-12785-BFK (Bankr. E.D. Va. May 24, 2012)	23 DAYS

EXHIBIT 2

THE ABILITY OF GUARANTORS TO INFLUENCE DEBTORS

CASE NUMBER	**(a)** **Did the guarantor(s) act as the DIP in the debtor's bankruptcy case?**	**(b)** **Is it the guarantor's signature that appears on the debtor's Chapter 11 petition as the individual authorized to file for bankruptcy?**	**(c)** **What role did the guarantor play in the debtor entity? (e.g., whether the guarantor had an ownership interest or held an officer position)**
(1) Lichtenstein	Yes.	No. It is the signature of the debtor's Secretary and General Counsel, Joseph Teichman.	Lichtenstein was the president of the corporate debtor, Extended Stay, Inc., and the 100% equity owner.
(2) Cotta	Yes.	Yes. Frank Cotta signs the petition as the debtor's "authorized individual."	Cotta is the Manager of Cotta Property Management, LLC, and he and his wife Florence owned 76.7% of the securities. Frank Cotta is also the debtor's property owner (see Doc. No. 80, US Trustee's Motion to Convert).
(3) Singh	Yes.	Yes. Gurpreet Singh, the guarantor, signs the petition.	Singh is the manager and 100% equity owner of the company (see debtor's Statement of Financial Affairs).
(4) Kobernick	Yes.	Yes. Mitchell Kobernick, the guarantor, signs the petition.	Kobernick was one of three people acting as the debtor's managers, directors, and 100% equity security holders.
(5) Perlmutter and Stark	Yes, the debtor in possession continued to manage the affairs of the debtor in the bankruptcy case between the filing date (4/30/2009) and January 15, 2014, when the bankruptcy court appointed a trustee in the case after Stark was murdered a few days earlier.	Yes. Both Israel Perlmutter and Menarchem Stark sign the petition.	Perlmutter and Stark were each 50% equity holders of the debtor, South Side House, LLC. Perlmutter was the President of another NY corporation that acted as the Managing Member of the Debtor.
(6) Rhodehamel, Kahn, and McMenamy, Jr.	Yes.	Yes. David R. Rhodehamel signs the petition.	David R. Rhodehamel is the President of Six Properties Management, Inc., which is the 0.5% owner of a membership interest in the Debtor, and Rhodehamel is the Managing Member of Six Holdings, LLC, which is the 99.5% owner of a membership interest in the debtor.

(7) Lahave	Yes.	Yes. Vito Gerbino signs the petition	Danny Lahave is the President, Director, and 100% Owner of the debtor's holding company, Top Terraces, Inc.
(8) Gerbino	Yes.	Yes. Vito Gerbino signs the petition.	Vito Gerbino is the sole manager/member of the debtor, and the Gerbino Family—a Limited Partnership—is the 100% equity owner. As an aside, there are three separate guarantors in this case who are all members of the Gerbino family: Vito, Frances, and Vincent Gerbino.
(9) Hoda and Saddel	Yes.	Yes. Dil Hoda is the authorized individual.	Dilawez Hoda and Gerard Saddel are both members of the debtor and 50% equity holders.
(10) Okun	Yes.	Yes. Edward H. Okun signs the petition.	Okun is the Manager of the General Partner of the debtor, IPofA WOM LeaseCo GP, LLC, which holds a 1% equity interest in the debtor. IPofA WOM LeaseCo LP, LLC, a limited partner, holds a 99% equity interest in the debtor.
(11) Garrison	Yes.	No. Julian Weldon, the Secretary and Vice President of the Debtor, signs the petition as the authorized individual.	The guarantor, Garrison Special Opportunities Fund LP holds 61.16% of indirect ownership interests in the Debtor.
(12) Sheppard and Wolman	Yes.	Yes. Eric D. Sheppard signs.	Sheppard is the Executive Manager and Operating Manager of Debtor and holds a 98% member interest, and Wolman holds a 1% member interest.

EXHIBIT 3

SURVEY OF SPRINGING GUARANTY CASES

CASE NAME	(a) State Court	(b) Federal Court	(c) Outcome	(d) Basis for Jurisdiction	(e) Triggering Condition(s)
(1) LBUBS 2004-C8 Derek Drive, LLC v. Gerbino		No. 2:13-CV-2264, 2014 WL 2446362, at *2, *6 (W.D. La. May 30, 2014)	HELD: The court relied on the four corners of the guaranty agreement to hold the guarantors liable for "the remaining principal amount due [$6,143,156.43], plus interest	Diversity. No subject matter jurisdiction ("SMJ") discussion in the opinion.	lender's collateral becoming an asset in borrower's bankruptcy case

			[$122,204.45], plus default interest [$329,469.58], late fees [$47,865.07], and attorney's fees [$70,584.36]."		
(2) LBCMT 2007-C3 Seminole Trail, LLC v. Sheppard		No. 3:12CV00025, 2013 WL 3009319, at *9 (W.D. Va. June 17, 2013)	HELD: The court relied on the four corners of the guaranty agreement to hold the guarantors liable in the amount of $3,444,770.54 plus interest in the amount of $642.29 for each day until the guarantor paid in full.	Diversity. No SMJ discussion.	lender's collateral becoming an asset in borrower's bankruptcy case
(3) LBCMT 2007-C3 Sterling Retail, LLC v. Sheppard		1:12-CV-470, 2013 WL 2151683, at *6 (E.D. Va. May 15, 2013)	HELD: The court relied on the four corners of the guaranty agreement to hold the guarantors liable for $4,599,985.43 plus $849.49 interest for each day until the guarantor paid in full.	Diversity. No SMJ discussion.	lender's collateral becoming an asset in borrower's bankruptcy case
(4) U.S. Bank Nat'l Ass'n v. Cotta		No. 11-CV-410, 2012 WL 5335999, at *4 (S.D. Tex. Oct. 26, 2012)	HELD: The court relied on the four corners of the guaranty agreement to hold the guarantor liable for "the principal amount of $3,144,603.34, plus pre-judgment interest in the amount of $276,035.28, plus attorneys fees and costs of $21,833.18, plus post-judgment interest at the prevailing rate."	Diversity. No SMJ discussion.	Borrower's bankruptcy filing and the lender's property becoming an asset in bankruptcy
(5) Wells Fargo Bank, Nat'l Ass'n v. Singh		No. H-12-0147, 2012 WL 3186036, at *3 (S.D. Tex. Aug. 2, 2012)	HELD: The court relied on the four corners of the guaranty agreement to hold the guarantor liable for $1,114,650.52, the outstanding amount due under the loan.	Diversity. No SMJ discussion.	Borrower's bankruptcy filing

(6) UBS Commercial Mortg. Trust 2007-FL1 v. Garrison Special Opportunities Fund L.P.	938 N.Y.S.2d 230, 230, n. 1 (N.Y. Sup. Ct. 2011)		<u>HELD</u>: The court relied on the four corners of the guaranty agreement to hold the guarantor fund liable for $111,514,324, the current principal amount of the loan.		Borrower's bankruptcy filing
(7) Bank of Am., N.A. v. Lightstone Holdings, LLC	938 N.Y.S.2d 225 (N.Y. Sup. Ct. 2011)		<u>HELD</u>: The court relied on the four corners of the guaranty agreement to hold the guarantor liable for up to the $100 million liability cap in the guaranty agreement.		Borrower's bankruptcy filing
(8) Monroe Ctr. II Urban Renewal Co., LLC v. Strategic Performance Fund-II	No. C-52-08, 2010 WL 5343317, at *2 (N.J. Super. Ct. App. Div. Dec. 29, 2010)		<u>HELD</u>: The court relied on the four corners of the guaranty agreement to hold the guarantors liable in the amount of $23,369,195.55.		Borrower's bankruptcy filing
(9) Wells Fargo Bank Minnesota, N.A. v. Kobernick		C.A. 8-cv-1458, 2009 WL 7808949, at *1 (S.D. Tex. May 28, 2009), *aff'd sub nom.*, U.S. Bank, Nat'l Ass'n v. Kobernick, 454 F. App'x 307 (5th Cir. 2011)	<u>HELD</u>: Although there was a waiver of the lender's right to claim default interest, the court still relied on the four corners of the guaranty agreement to hold the guarantor liable for the original amount of the loan, $7,150,000.	Diversity. No SMJ discussion.	lender's collateral becoming an asset in borrower's bankruptcy case
(10) GCCFC 2006-GG7 Westheimer Mall, LLC v. Okun		07 Civ. 10394 (NRB), 2008 WL 3891257, at *4 (S.D.N.Y. Aug. 21, 2008)	<u>HELD</u>: The court relied on the four corners of the guaranty agreement to hold the guarantor liable in the amount of $103,501,565.22 plus interest through March 6,2008	Diversity. No SMJ discussion.	Borrower's bankruptcy filing

(11) 111 Debt Acquisition Holdings LLC v. Six Ventures, Ltd. et al.		413 F. App'x 824 (6th Cir. 2011)	HELD: affirming the District Court's final judgment order holding the guarantor liable in the amount of $10,560,000	Diversity. No SMJ discussion.	Borrower's bankruptcy filing
(12) Wells Fargo Bank, N.A. v. Daniels	Nos. C-110209, C-110215, 2011 WL 6677982, *4, (Ohio Ct. App. Dec. 21, 2011)		HELD: The guarantor is liable in the amount of $10,275,707.73.		Borrower's bankruptcy filing
(13) LSREF2 Baron, LLC v. Aguilar		3:12-CV-1242-M, 2013 WL 230381 (N.D. Tex. Jan. 18, 2013)	HELD: referred the decision on the merits to the Bankruptcy Court	Finding the Bankruptcy Court to have "related to" jurisdiction over the springing guaranty proceeding	The lender's collateral becoming the subject of a foreclosure proceeding
(14) JPMCC 2007-C1 Grasslawn Lodging, LLC v. Dix		CV-11-00017-TUC-CKJ, 2013 WL 1340039, at *9 (D. Ariz. Apr. 1, 2013)	HELD: The guarantor is liable for "a total of $307,173,991.57 in damages, plus accrued interest, late fees and other chargeable fees and costs."	Diversity. No SMJ discussion.	Borrower's bankruptcy filing
(15) 8375 Honeytree Blvd. Holdings, LLC v. Starman		11-12431, 2012 WL 683379 (E.D. Mich. Mar. 2, 2012)	HELD: The guarantors are liable for the amount of the loan - $29,280,000 minus the amount paid by the lender at the foreclosure sale of the property - $20,000,000.	Diversity. No SMJ discussion.	Borrower's allowance of a number of construction liens to be placed on the property securing lender's loan and borrower's bankruptcy filing
(16) Prestige Capital Corp. v. Michigan Gage & Mfg., LLC		722 F. Supp. 2d 837 (E.D. Mich. 2010)	HELD: The guarantors are liable pursuant to the guaranties, but the lenders have still not offered sufficient evidence as to their	Diversity. No SMJ discussion.	Borrower's default on the loan and subsequent bankruptcy filing

			damages. The case is remanded on the issue of damages.		
(17) *In re* S. Side House, LLC		470 B.R. 659 (Bankr. E.D.N.Y. 2012)	HELD: referred the decision on the merits to the Bankruptcy Court	Finding the Bankruptcy Court to have “related to” jurisdiction over the springing guaranty proceeding	Borrower’s bankruptcy filing
(18) S1 Inv. US-Re Holdings 2009-1, Inc. v. Englett		609-CV-281-ORL-28DAB, 2009 WL 1659164 (M.D. Fla. June 12, 2009)	HELD: referred the decision on the merits to the Bankruptcy Court	Finding the Bankruptcy Court to have “related to” jurisdiction over the springing guaranty proceeding	Borrower’s bankruptcy filing
(19) LBCMT 2007-C3 Urbana Pike, LLC v. Sheppard		CIV. JKB-12-3056, 2014 WL 1388409 (D. Md. Apr. 9, 2014)	HELD: The guarantors are liable pursuant to the individual recourse guaranty agreements for the principal sum of $1,750,000 and $4,160,000, respectively.	Diversity. No SMJ discussion.	Failure to pay rents collected by the borrower and misappropriate of rents in connection with several single-purpose entity lenders (SPEs)
(20) First Nationwide Bank v. Brookhaven Realty Assocs.	637 N.Y.S.2d 418 (N.Y.App.Div.), *appeal dismissed*, N.E.2d 1347 (N.Y. 1996)		HELD: The individual partners – acting as the guarantors on a loan granted to the general partnership – were held personally liable for the amount of the mortgage and any deficiency upon the partnership’s filing for bankruptcy.		Borrower’s bankruptcy filing and failure to dismiss case within 90 days of that filing
(21) Wells Fargo Bank Minnesota, N.A. v. Rouleau	2012 VT 19, 191 Vt. 302, 46 A.3d 905 (Vt. 2012)		HELD: The guarantor is liable on the $2.15 million loan agreement.		Borrower’s bankruptcy filing