

Enforcing “Bad Boy” Guaranties When the Borrower Files for Bankruptcy Protection

Have you ever gone through an entire foreclosure action only to have the borrower, usually a special purpose entity, file for bankruptcy protection on the eve of sale? If you have - and what lender hasn't? - you know how frustrating that can be. The traditional solution has been to move to lift the automatic stay in the bankruptcy court. A recent decision from the Commercial Division of the Supreme Court of New York County offers a new option for lenders facing such a situation.

In *172 Madison (NY) LLC v. NMP-Group, LLC*, N.Y. Co. Index No. 650087/2010, the Commercial Division court granted summary judgment in favor of the lender-mortgagee against guarantors who had signed a non-recourse guaranty that had a “bad boy” provision which operated to turn the guaranty into a full recourse guaranty if the borrower-mortgagor filed for bankruptcy. The Court rejected the guarantors’ argument that New York’s “one action rule” prohibited the lender from seeking summary judgment against the guarantors while the foreclosure action, although stayed, was still pending. The Court found that because the lender could not have sued on the full recourse guaranty unless and until the borrower filed for bankruptcy the lender had not elected between bringing a foreclosure action and suing the guarantors on their recourse guaranty when it commenced the foreclosure action. As the Court held, the election of remedies “doctrine only operates when there was a choice of remedies available at the time the prior actions were undertaken.”

The Court gave the lender the option of enforcing either the foreclosure judgment or money judgment on the guaranty first. The case settled shortly after the Court issued its decision and before the issue could be addressed by an appellate court. The decision, however, is very well reasoned and was issued by the highly regarded Commercial Division of New York County Supreme Court. We believe that other judges and courts may well adopt this ruling. Please contact Tom Baylis at tbaylis@cullenanddykman.com or at 516-357-3748 with any questions you may have.

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