



LENDING AND RESTRUCTURING ALERT

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HERRICK

New York Office

2 Park Avenue
New York, New York 10016
Phone: (212) 592-1400
Fax: (212) 592-1500

Princeton Office

210 Carnegie Center
Princeton, New Jersey 08540
Phone: (609) 452-3800
Fax: (609) 520-9095

Newark Office

One Gateway Center
Newark, New Jersey 07102
Phone: (973) 274-2000
Fax: (973) 274-2500

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Divided Court Holds That Guarantor Was Not Relieved of Liability By Subsequent Modification of the Underlying Note

This case suggests that a prudent borrower will require a guarantor to agree expressly to modifications to the underlying promissory note.

The Facts

The guarantee under consideration provided that the guarantor waived "notice of . . . modification or alteration of the terms of the within note." The terms of the 1994 note were modified in 1996. The guarantor argued that he was relieved of his guarantee obligations by the modification, because he did not agree to it.

The Decision

The majority of the appellate panel rejected that argument, and held that a guarantor is not relieved of his obligations where the written guarantee allows for changes in the terms of the guarantee and expressly waives notice to the guarantor of those changes. Splitting hairs, the dissenting judge argued that the waiver of notice contained in the guarantee should not be equated with a consent to the modifications of the note. He observed that the note — which was not signed by the guarantor — provided that the guarantor consented to modifications of the note. This judge contended that the majority's reading of the guaranty rendered redundant the consent language contained in the note.

The majority held that the terms of the note and guarantee must be viewed as one transaction. The dissent disagreed because there was no evidence indicating whether the guarantee was signed when the note was made. The lender won this battle even though the guarantor did not expressly consent to the modification. But the practical implication of this case is that, whenever possible, it behooves the lender to obtain written consents so that the guarantor's obligations are clear.

Foreclosure Sale Voided as a Fraudulent Conveyance

A New Jersey bankruptcy judge recently voided a pre-bankruptcy foreclosure sale of commercial property as a fraudulent conveyance because it was advertised at a misleading price.

The Facts

The mortgagee obtained a final judgment of foreclosure on January 11, 1999 in the approximate amount of \$216,000. The sale was advertised several times in February and March 1999. The advertisement stated that the amount of the judgment to be satisfied was nearly \$220,000. Then the sale was adjourned because the mortgagee entered into a forbearance agreement with the borrower. The borrower proceeded to pay the mortgagee approximately \$170,000 in accordance with that agreement.



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After the borrower stopped making payments, a sheriff's sale was held on October 25, 1999. The mortgagee's bid of \$100 over the amount of its unsatisfied lien (about \$50,000) was the winning —and only — bid. The property was re-sold a few months later for \$215,000.

The borrower filed a Chapter 13 bankruptcy petition in November 1999. He then sued the mortgagee, arguing that the foreclosure sale should be voided as a fraudulent conveyance because the February-March sale notices overstated the amount of the judgment to be satisfied at the time of the October sale. The borrower alleged this caused a lack of competitive bidding and an inadequate sale price.

The Decision

The bankruptcy court noted that one of the situations in which the Bankruptcy Code permits a debtor to avoid a transfer of a debtor's property is where the debtor receives less than "reasonably equivalent value" in exchange for the transfer. The court also acknowledged that the United States Supreme Court ruled previously that "reasonably equivalent value" is deemed to have been received in a foreclosure sale if all of the requirements of the state's foreclosure law have been complied with.

Accordingly, the bankruptcy court addressed whether the foreclosure sale should be voided under New Jersey foreclosure law. In this case, the foreclosure sale was advertised in newspapers, notice was posted in the sheriff's office, and these sale notices specified the amount of the judgment to be satisfied by the sale, all as required by New Jersey law. But the notices stated that the amount of the judgment to be satisfied was approximately \$220,000. Though that may have been accurate when those notices were published, over 75 percent of the outstanding amount had been satisfied before the sale was actually held.

The mortgagee did not post any new advertisements proclaiming the reduced amount for which the property could be purchased on the October sale date. Because there was no re-advertisement, the potential bidding public was unaware of the substantial equity now in the property. As a result, the mortgagee obtained property worth more than \$200,000 for approximately \$50,000. The court concluded that the lack of competitive bidding was probably the result of the mortgagee's failure to give notice as to the true amount of outstanding debt at the time of the sale.

This case illustrates that notices of foreclosure sales must (a) include accurate information concerning the outstanding debt to be satisfied at the time of the sale; and (b) be disseminated in a manner designed to insure the opportunity for competitive bidding. Though this decision was issued in a Chapter 13 case, the same principles would also apply in Chapter 7 or Chapter 11 bankruptcy cases.

For more information on these issues, please call Paul Rubin 212-592-1448 or prubin@herrick.com, Andrew Gold 212-592-1459 or agold@herrick.com, or Scott Tross 973-274-2030 or stross@herrick.com.

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