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LENDING AND RESTRUCTURING ALERT
FEBRUARY 2009

THE HERRICK ADVANTAGE

Herrick Wins Major Victory for Bankruptcy Trustee: On February 3, 2009, ruling on issues of first impression, the Third Circuit Court of Appeals upheld the judgment that Herrick won in favor of the Chapter 7 Trustee of Winstar Communications Inc., which is valued at over $340 million. For more information, visit our website at www.herrick.com.

When Does a Lender Need a Reaffirmation From a Guarantor?

Lenders commonly require reaffirmations from all guarantors whenever provisions in loan documents are being modified or waived. This is because, under New York case law, a guarantor can be deemed released from its obligations if a significant loan term—such as an increase in the amount guaranteed, a change in a payment schedule, or the release of collateral or of another obligor—is modified without its consent. Rather than worry whether a particular waiver or amendment might eviscerate the guaranty, banks usually choose to have guarantors reaffirm their guaranties whenever loan terms are varied. This practice has long been followed even though most banks' form guaranties contain "waivers of suretyship defenses," which provide that the guarantors prospectively agree to remain liable regardless of subsequent material amendments to the agreements between the bank and the borrower.

In better economic times, loan waivers and amendments are usually routine matters that are used, for example, to clean up technical defaults, or to increase availability or extend maturity. In such happier circumstances, it is typically not difficult for lenders to obtain a reaffirmation from guarantors. But during economic downturns, when, in response to a default, banks are more likely to raise interest rates, demand restructuring fees, shorten maturities or limit availability, lenders are more likely to encounter a recalcitrant guarantor who refuses to execute a reaffirmation. (In a closely held business, this will typically be a minority owner or a former partner who has not been released as to the bank loan.)

What this Means to Lenders

If the guaranty contains a well-drafted waiver of suretyship defenses, and if New York law applies, the lender can proceed to close the waiver, amendment or restructuring and safely assume that a guarantor who declined to reaffirm will, nonetheless, continue to be bound by the guaranty. One cautionary note: New York law recognizes the concept of a "novation," in which the original loan agreement (which was guaranteed) is terminated and replaced by a new one (that is not). In theory, a novation—which lenders want to avoid—could be found whenever existing loan terms are significantly modified. However, there are almost no cases where a court has found a novation in the face of a broad and unambiguous suretyship defense waiver. In fact, it seems clear from the reported decisions that, absent an entirely new note or loan agreement clearly stating that it "replaces" or "supersedes" the original, a waiver of suretyship defenses will be enforced as written.

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What to Do—And What to Avoid:

1. Where a reaffirmation cannot be obtained, avoid using words such as "supersede" or "replace" or similar phrases when amending or restating loan documents.

2. When a lender anticipates receiving an incomplete set of reaffirmations, it should add language to the reaffirmation provision clarifying that this is being provided by the guarantor(s) merely as a "further assurance." This enables the lender to explain later—to a court, if necessary—that a reaffirmation was not even required in the first place.

3. If you are in doubt regarding the strength of the waiver of suretyship defenses in the guaranty you are holding, or if the law of a state other than New York applies, consult with your counsel, who should examine the language and the underlying facts, and recommend a course of action for you.

If you have any questions or would like our assistance in formulating appropriate language, contact: **Stephen D. Brodie** at **(212) 592-1452** or **sbrodie@herrick.com** or **Paul A. Rubin** at **(212) 592-1448** or **prubin@herrick.com**.

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