

## **LENDERS BEWARE OF TWO DOLLAR BANKRUPTCY**

Most lenders usually only involve legal in problematic or highly-complicated transactions; otherwise, business would grind to a halt. Most loan documents are created using form software or are reused from prior transactions. The unwary lender, however, may inadvertently create an enforcement trap. Even with careful underwriting, some borrowers will default — it is inevitable. If that defaulting obligation is secured by a personal guaranty from an Arizona resident, there may be enforcement problems.

For many years, an Arizona debtor could place his/her future wages and commingled community property assets outside of the reach of his/her creditors simply by getting married. Thus, getting married in Arizona has been colloquially referred to as a “two-dollar Bankruptcy.” The term-of-art “two-dollar Bankruptcy” refers to initial cost of an Arizona marriage license, which was at one time two-dollars. Although the scope of the “two-dollar Bankruptcy” has been significantly narrowed though legislative and case law developments, its protections subsist in certain contexts. One of these contexts is personal guaranties. Under Arizona law, both spouses must execute a personal guaranty to bind the marital community. *See* Ariz. Rev. Stat. § 25-214(c)(2); *Rackmaster Systems, Inc. v. Maderia*, 193 P.3d 314 (Ariz. App. 2008). This limitation has been extended to non-Arizona resident debtors in the context of Arizona enforcement proceedings (*see Phoenix Arbor Plaza Ltd. v. Dauderman*, 785 P.2d 1215 (Ariz. App. 1989)) and Arizona debtors in the context of non-Arizona enforcement proceedings (*see G.W. Equipment Leasing, Inc. v. Mt. McKinley Fence Co.*, 982 P.2d 114 (Wash. App.1999)). Thus, under Arizona law, if only one spouse executes a personal guaranty, only that spouse’s separate marital property is subject to the claims arising under that guaranty. Since most assets acquired and income earned after the formation of a marriage are deemed community property, under such circumstances there will be a much smaller universe of assets upon which a lender can enforce its guaranty claims.

So, what is a lender to do? Stop doing business with Arizona residents? Obviously not. Require both spouses to execute a personal guaranty in all states, even when it is not needed to bind the marital community — also a bad idea since that may kill certain deals. The practical solution is for lenders to require execution of a personal guaranty by both spouses in an Arizona marital community and to include in that guaranty a choice of non-

Arizona law and a waiver (by both spouses) of the protections of Arizona community property law. If the lender cannot get both spouses to execute the personal guaranty, then this should be taken into consideration in the underwriting process.

It is also worth noting that Arizona is not the only state with protective community property laws. Furthermore, in states such as Arizona, the failure to name both spouses as defendants in certain types of actions can preclude enforcement of any resulting judgment against marital community assets. *See, e.g.,* Ariz. Rev. Stat. § 25-215(D)(10); *Spudnuts, Inc. v. Lane*, 676 P.2d 669, 670 (Ariz. App. 1984). It is therefore a good idea to become familiar with the community property laws of the state in which your borrower, guarantor, or debtor resides both when entering into a transaction and when commencing legal proceedings to enforce claims.