

ORDERED.



Dated: September 07, 2010

*Eileen W. Hollowell*

EILEEN W. HOLLOWELL  
U.S. Bankruptcy Judge

IN THE UNITED STATES BANKRUPTCY COURT  
FOR THE DISTRICT OF ARIZONA

10	In re:	)	
		)	Chapter 11
11	WHETSTONE DEVELOPMENT	)	
12	COMPANY,	)	Case No. 4:09-bk-10701-EWH
		)	
13	Debtor.	)	
14	_____	)	
15	NATIONAL BANK OF ARIZONA,	)	Adv. No. 4:09-00913-EWH
	a national banking association,	)	
16		)	
	Plaintiff,	)	
17	vs.	)	
18	WHETSTONE DEVELOPMENT	)	<b>MEMORANDUM DECISION</b>
19	COMPANY, an Arizona corporation;	)	<b>ON MOTION FOR SUMMARY</b>
	and ERNEST L. GRAVES and	)	<b>JUDGMENT REGARDING</b>
20	MARY G. GRAVES, husband and	)	<b>ENFORCEMENT AND AMOUNT</b>
21	wife,	)	<b>OF GUARANTY</b>
		)	
22	Defendants.	)	
23	_____	)	

**I. INTRODUCTION**

Guarantors seek to avoid immediate liability on their guaranty, but such a result is inconsistent with the terms of the agreement and unsupported by Arizona law.

Accordingly, summary judgment will be awarded to the Plaintiff.

1 **II. FACTUAL AND PROCEDURAL HISTORY**

2 In February 2005, Ernest and Mary Graves (“Graves”) executed a Repayment  
3 Guaranty (“Guaranty”) in conjunction with an \$8.3 million construction, acquisition and  
4 development loan (“Loan”) made to Whetstone Development, Inc. (“Whetstone”) by  
5 National Bank of Arizona (“National Bank”). The Loan was made as part of Whetstone’s  
6 development of a master planned community in Benson, Arizona and was secured by  
7 the real property to be developed and other assets related to the construction of the  
8 master planned community (“Whetstone Assets”). Payments on the Loan were to be  
9 monthly interest only with a final balloon payment (“Balloon”) due on the maturity date,  
10 which was originally February 2, 2007. The Loan provided for a variable rate of interest,  
11 an 18% default interest rate and assessment of a 10% late fee on “any payment of  
12 interest and/or principal” not received when due (“Late Fee”).<sup>1</sup> The Loan permitted  
13 National Bank to advance the monthly interest payments from the Loan proceeds.  
14

15  
16 The Loan was the subject of several modifications, extension and forbearance  
17 agreements, all of which were made with the Graves’ knowledge. The last forbearance  
18 agreement expired in early November 2008. In January 2009, National Bank notified  
19 Whetstone and the Graves that the entire \$9+ million balance of the Loan was due, that  
20 interest was accruing at the default rate and that the Late Fee was being assessed  
21 against all past due payments, including the Balloon (“Declaration of Default”).  
22

23 In February 2009, National Bank filed suit against the Graves on the Guaranty  
24 (“Guaranty Suit”) and also filed a motion for partial summary judgement (“MPSJ”)  
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26 <sup>1</sup> Exhibit 2, Secured Promissory Note, paragraph 6(b). (All exhibit numbers refer to  
27 exhibits admitted into evidence at 8/23/2010 evidentiary hearing.)

1 seeking a determination that the Graves were liable on the Guaranty and that, due to  
2 the Declaration of Default, the Graves were in default on that liability.

3           In May 2009, Whetstone filed for Chapter 11 relief. The Graves removed the  
4 Guaranty Suit to this court in August 2009. In their opposition to the MPSJ, the Graves  
5 did not contest their liability or breach of the Guaranty, but asserted that National Bank  
6 could not seek a judgment on the Guaranty without first: (1) foreclosing its security  
7 interest on the Whetstone Assets; or (2) waiving its security interest in the Whetstone  
8 Assets. The summary judgment proceeding was continued from time to time by  
9 agreement of the parties.  
10

11           In October 2009, Whetstone began making monthly interest payments on the  
12 Loan. Whetstone and National Bank entered into stipulations, which permitted  
13 Whetstone to sell lots during the course of its Chapter 11 case. The parties also agreed  
14 that the amount of Whetstone's secured claim was \$6,825,000.  
15

16           Nevertheless, National Bank opposed confirmation of Whetstone's Plan of  
17 Reorganization ("Plan"). A contested evidentiary confirmation hearing and oral  
18 argument on the MPSJ were held on May 10, 2010. At that hearing, the court ruled that  
19 the Plan could be confirmed if Whetstone made certain modifications regarding the  
20 interest rate payable on National Bank's secured claim and made certain "curtailment"  
21 payments every six months. The court set a deadline for Whetstone to file new *pro*  
22 *formas* based on the court required modifications and to file a proposed confirmation  
23 order.  
24

25           At the May 10, 2010 hearing, the court also granted National Bank's MPSJ on  
26 the issue of the Graves' liability on the Guaranty, but made no determination of the  
27

1 amount of their liability. On May 11, 2010, National Bank lodged an order granting it  
2 partial summary judgment on the Guaranty. The Graves objected to the proposed  
3 order. The Graves also moved for reconsideration of the court's ruling ("Motion for  
4 Reconsideration"), again urging the court to hold that National Bank had to elect to  
5 either waive its security interest in the Whetstone Assets or foreclose on those assets  
6 before enforcing the Guaranty. The Graves also contested National Bank's assessment  
7 of default interest and the Late Fee in its Declaration of Default. In National Bank's  
8 response to the Motion for Reconsideration, it agreed to credit the amount of its secured  
9 claim against the amount of any judgment on the Guaranty.  
10

11  
12 A hearing was held on June 29, 2010 on the Motion for Reconsideration, along  
13 with a show cause hearing regarding the failure of Whetstone to timely file the new *pro*  
14 *formas* required by the court at the May 10, 2010 hearing. Prior to the hearing,  
15 Whetstone filed new *pro formas* and indicated it wished to confirm the Plan. On  
16 June 29, 2010, an order was entered confirming the Plan ("Confirmation Order"). The  
17 Confirmation Order provided that sale proceeds from pre-confirmation lot sales would  
18 be applied to National Bank's secured claim and set a July 26, 2010 deadline for  
19 objections to National Bank's calculation of its unsecured claim of \$3,625,876. Both  
20 Whetstone and the Graves timely filed objections to Whetstone's unsecured claim.  
21

22 A combined hearing on the Graves' Motion for Reconsideration and on the  
23 objections to National Bank's unsecured claim was held on August 23, 2010. At that  
24 hearing, National Bank presented evidence regarding the calculation of its claim.  
25 Whetstone and the Graves cross-examined National Bank's witness and presented  
26 argument. The parties' dispute regarding the calculation of National Bank's unsecured  
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1 claim centered around whether the Late Fee applied to the Balloon, on whether National  
2 Bank was entitled to monthly interest payments after the Loan's maturation, and  
3 whether the Late Fee applied to such monthly payments.  
4

5 At the hearing, the court orally ruled that, as to Whetstone, the confirmation of  
6 the Plan set aside the Declaration of Default, and, because the Plan extended the Loan  
7 term, no Late Fee was due from Whetstone on the Balloon. The Late Fee could,  
8 however, be assessed against all prepetition and pre-confirmation interest payments,  
9 including those assessed by National Bank after the Declaration of Default. The court  
10 also ruled that interest on any unpaid monthly interest payments accrued at the default  
11 rate prepetition and the contract rate postpetition.  
12

13 The matter remaining to be decided in this Memorandum Decision, therefore,  
14 relates to the MPSJ, the Motion for Reconsideration and the Graves' claim that their  
15 obligation on the Guaranty has been modified by the confirmation of the Plan.<sup>2</sup> Both  
16 sides were given additional time to provide the court with case authority supporting their  
17 arguments. Those authorities have been submitted and the matter is ready for decision.  
18  
19

### 20 **III. STATEMENT OF JURISDICTION**

21 Jurisdiction over Graves' claims objection is proper under 28 U.S.C.  
22 § 157(b)(2)(B). The parties have consented to the court's jurisdiction over the MPSJ  
23 pursuant to 28 U.S.C. § 157(c)(2).  
24

25 \_\_\_\_\_  
26 <sup>2</sup> The Graves raised no new evidence or legal arguments in the Motion for  
27 Reconsideration and, therefore, the legal analysis for the Motion for Reconsideration is the  
28 same as for the MPSJ.

1 **IV. ISSUES**

- 2 A. Must National Bank foreclose or waive its security interest in the  
3 Whetstone Assets before enforcing the Guaranty?  
4  
5 B. Did confirmation of the Plan modify the Guaranty to a guarantee solely of  
6 Whetstone's Plan obligations?  
7  
8 C. Is National Bank barred from claiming the Late Fee, as part of the  
9 Guaranty obligation, if the Balloon was not an installment payment?  
10  
11 D. Is National Bank barred from claiming monthly interest payments, as part  
12 of the Guaranty obligation, after the maturity date of the Loan?  
13

13 **V. DISCUSSION**

14 1. National Bank Does Not Have to Elect its Remedies Before Obtaining a  
15 Judgment on the Guaranty

16 The Graves contend that ARIZ. REV. STAT. § 33-722 requires National Bank to  
17 either foreclose on the Whetstone Assets or waive its security interest in those assets  
18 before it can enforce the Guaranty. However, § 33-722 only applies if a lender who  
19 holds a deed of trust on non-residential real property elects to judicially foreclose that  
20 deed of trust. See Mid Kansas Fed. Sav. and Loan Ass'n v. Dynamic Dev. Co.,  
21 167 Ariz. 122, 126 n.2, 804 P.2d 1310, 1314 (1991). See also Valley Nat'l Bank of Ariz.  
22 v. Kolhase, 182 Ariz. 436, 438, 897 P.2d 738, 749 (App. 1995) ([b]anks need not  
23 choose between conducting trustee's sale and suing on note). National Bank has  
24 stated in its pleadings that it does not intend to judicially foreclose its security interest in  
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28

1 the Whetstone Assets. Accordingly, Graves' argument that § 33-722 requires National  
2 Bank to elect its remedies fails.

3         The Graves also argue that, unless National Bank is required to elect its  
4 remedies, the Graves' statutory right under ARIZ. REV. STAT. § 12-1566(E) to a credit for  
5 the value of the Whetstone Assets, will be rendered meaningless. Section 12-1566(E)  
6 provides the Graves with the same credit rights as those available to a judgment debtor  
7 under ARIZ. REV. STAT. § 33-814. The court in Kolhase found that a creditor could  
8 obtain a judgment for the full amount of an obligation against a judgment debtor and  
9 that the amount of the judgment would then be reduced by any subsequent sale of  
10 collateral which secured the obligation. 182 Ariz. at 440, 897 P.2d at 742. The Graves,  
11 as guarantors, have no greater rights than a judgment debtor and, therefore, there is no  
12 requirement under § 33-814 that National Bank waive or foreclose its security interest in  
13 the Whetstone Assets before it enforces the Guaranty.

14         In addition, § 33-814(C) specifically permits actions against guarantors  
15 "regardless of whether a trustee's sale is held." See Crown Life Ins. Co. v. Howard,  
16 170 Ariz. 130, 822 P.2d 483 (App. 1991). In Crown Life, as in this case, the guarantors  
17 agreed that the lender could enforce the guarantee without regard to whether a trustee's  
18 sale was held.<sup>3</sup> In light of such a provision, the Crown Life court found no merit to the  
19 argument that a lender must liquidate its security before enforcing the guarantee.  
20 170 Ariz. at 133, 822 P.2d at 484. Furthermore, National Bank has offered to reduce  
21 the amount of any Guaranty judgment by the amount of its secured claim. Accordingly,  
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27 <sup>3</sup> Exhibit 4, paragraph 6 of Repayment Guaranty.

1 there is no evidence that the Graves' rights to a credit for the value of the Whetstone  
2 Assets will be rendered meaningless if National Bank obtains a judgment on the  
3 Guaranty before it pursues recovery of its collateral.

4  
5 2. Confirmation of the Plan does not convert the Guaranty into a Guarantee of  
6 Performance Under the Plan

7 Under Arizona law, "the nature and extent of guarantor's liability depends upon  
8 the terms of the guaranty contract." Tenent HealthSystem TGH, Inc. v. Silver, 203 Ariz.  
9 217, 219, 52 P.3d 786, 788 (Ariz. 2003). Because the Guaranty states that it is "a  
10 guaranty of payment and not of collectability,"<sup>4</sup> it is a payment guarantee which made  
11 the Graves jointly and severally liable for the Loan.

12 Whetstone's obligations for the Loan have been modified and extended by the  
13 confirmation of the Plan, but that does not relieve the Graves of their liability on the  
14 Guaranty, which is a separate and distinct obligation. 11 U.S.C. § 524(e). See also  
15 Star Phoenix Mining Co. v. West Bank One, 147 F.3d 1145, 1147-48 (9th Cir. 1998); In  
16 re American Hardwoods, 885 F.2d 621, 626 (9th Cir. 1989).<sup>5</sup>

17  
18 In addition, paragraph 3 of the Guaranty provides that the Graves are liable for  
19 the Loan, notwithstanding "any modification, agreement or stipulation" between  
20 Whetstone and National Bank.<sup>6</sup> Because the terms of the Guaranty provide for  
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22  
23  
24 <sup>4</sup> Exhibit 4, Paragraph 5.

25 <sup>5</sup> The Graves have cited a number of cases to the court which stand for the proposition  
26 that the Plan modified the Loan. The court agrees, but those cases do not hold that  
modification of a loan under a confirmed plan modifies a guarantee.

27 <sup>6</sup> Exhibit 4, paragraph 3(a).



1 continuing liability of the Graves regardless of modifications to the Loan, the  
2 confirmation of the Plan did not modify the Graves' obligations under the Guaranty.

3 3. Late Fee on the Balloon Applies to the Guaranty

4 The Graves argue that, under the terms of the Loan, the Late Fee does not apply  
5 to the Balloon, but only to the pre-maturity monthly interest payments. They rely on  
6 Section 6(b) of the Secured Promissory Note (Exhibit 2) which provides:  
7

8 If any payment of interest and/or principal is not received by the holder  
9 hereof when such payment is due, then in addition to the remedies  
10 conferred upon the holder hereof pursuant to Paragraph 10 hereof and the  
11 other Loan Documents, (i) a late charge of ten percent (10%) of the  
12 amount of the installment due and unpaid will be added to the delinquent  
13 amount to compensate the holder hereof for the expense of handling the  
14 delinquency for any payment past due in excess of ten (10) days,  
15 regardless of any notice and cure periods, and (ii) the amount due and  
16 unpaid (including, without limitation, the late charge) shall bear interest at  
17 the Default Interest Rate, computed from the date on which the amount  
18 was due and payable until paid. (emphasis added)

19 Under Arizona principles of contract interpretation, the provisions of a contract  
20 must be read in their entirety in order to effectuate the parties' intent. Tenent  
21 HealthSystem TGH, Inc., 203 Ariz. at 219-20, 52 P.3d at 788-89 citing Taylor v. State  
22 Farm Mut. Auto Ins. Co., 175 Ariz. 148, 854 P.2d 1134 (1993). The first sentence of  
23 paragraph 6 provides that the Late Fee applies to any payment of interest and/or  
24 principal not received when due. The only payment of principal on the Loan is the  
25 Balloon. So regardless of whether the Balloon is an installment payment,<sup>7</sup> paragraph 6  
26 applies to it, otherwise the first sentence of paragraph 6 is rendered meaningless. The

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26 <sup>7</sup> As noted in a case cited by the Graves, a payment does not have to be equal to all  
27 other payments to be an "installment." Poseidon Dev., Inc. v. Woodland Lane Estates, LLC,  
28 152 Cal. App. 4th 1106, 1113 (App. 2007).

1 court notes that a finding that National Bank may assess the Late Fee on the Balloon in  
2 enforcing the Guaranty may result in the Graves owing more to National Bank than  
3 Whetstone. Such a result is permitted under Arizona law. See Provident Nat'l  
4 Assurance. Co. v. Sbrocca, 180 Ariz. 464, 466, 885 P.2d 152, 154 (App. 1994).  
5

6 4. Post-Loan Maturation Monthly Interest Payments

7 The Graves argue that there could be no default in monthly interest payments  
8 after the Loan matured because the Loan does not provide for such payments. In its  
9 oral ruling on August 23, 2010, the court found that those payments were an allowed  
10 part of National Bank's unsecured claim. The court's ruling was based on the pattern of  
11 conduct between National Bank and Whetstone. Commencing in October 2009,  
12 Whetstone began making monthly interest payments to National Bank. The Graves, as  
13 active participants in the Whetstone Chapter 11, never objected to those payments.  
14 Like the other prepetition Loan extensions, modifications and forbearance agreements,  
15 the continued accrual of monthly interest payments, post-maturity, was consented to by  
16 the Graves. In addition, under paragraph 3(b) of the Guaranty, the Graves agreed that  
17 National Bank could apply any payments made by Whetstone as National Bank "may  
18 elect."  
19  
20  
21

22 **VI. CONCLUSION**

23 The foregoing constitutes the court's finding of fact and conclusions of law under  
24 Rule 7052. National Bank is entitled to judgment on the Guaranty for the full amount of  
25 the Loan, plus interest at the default rate and the Late Fee from and after the  
26  
27

1 Declaration of Default. Counsel for National Bank is directed to upload a form of  
2 judgment consistent with this decision.

3 Dated and signed above.  
4

5  
6 Notice to be sent as indicated below:

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