Guaranties still raise plenty of issues and concerns for lenders.

**MANY COMMERCIAL REAL ESTATE LOANS** rely on personal guaranties. Those guaranties usually cover only certain obligations of the borrower. Sometimes, they cover all loan obligations or at least a meaningful part of the principal indebtedness. (Partial principal guaranties merit an article, or perhaps a book, of their own. They raise a panoply of issues about the interaction between paydowns (voluntary or involuntary) and the scope of a guarantor’s exposure. The outcomes of those legal issues often do not conform to the parties’ business expectations, and those expectations are often murky in any case.) Regardless of what guaranties cover, however, lenders want to know the courts will enforce them and that lenders won’t face unpleasant surprises in court.

Guaranties have played a significant role yet again in some of the loan enforcement litigation spawned by the recent financial meltdown. Lenders and sometimes guarantors have (re)learned about pitfalls in enforcing guaranties. And when lenders work out troubled loans instead of enforcing them, lenders sometimes have a chance to improve the language of their guaranties, and borrowers may be called upon to provide new or improved guaranties.

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This article is based on and updates *The 24 Defenses of the Guarantor* (pts. 1-3), Secured Lending Alert (Nov.-Jan. 1987-88) by Barkley Clark and Barbara Clark, authors of Clark’s Secured Transactions Monthly and The Law of Secured Transactions Under the UCC. The authors of today’s article thank the authors of the earlier series of articles and Sheshunoff/A.S. Pratt & Sons, publisher of that earlier series, for consenting to the publication of this article, which uses the 1987 series as its starting point and would probably otherwise violate copyright. The authors of today’s article also thank Sean Weisberg, New York University Law School class of 2012; Robert J. Gorrie, Pace Law School class of 2012; and Alfredo R. Lagamon, Jr. of Ernst & Young, for their helpful editorial comments. Blame only today’s named co-authors for any mistakes in today’s article, however. Copyright © 2012 Joshua Stein and Elaine Wang. The authors consent to any copying, updating, and adaptation of this article, but only starting 24 years after publication.
Whether for new loans or for enforcement or workouts of old loans, lenders and their counsel approach guaranties knowing that for decades the courts have protected any guarantor (sometimes called the “fool with a pen”) by upholding defenses that allow the guarantor to disclaim liability.

In the late 1980s, articles in three issues of the Secured Lending Alert newsletter highlighted 24 defenses that guarantors often raise when a lender tries to enforce a guaranty. The 24 Defenses of the Guarantor (pts. 1-3), Secured Lending Alert (Nov.-Jan. 1987-88). Those common defenses fell into five general groups:

- Basic contract law;
- Disclosure;
- Scope-of-risk;
- Primary obligation; and
- Bankruptcy.

Each defense can potentially derail or delay enforcement of the guaranty, thus producing counterintuitive results for the lender.

Careful drafting can protect a lender from many of these defenses. This article seeks to revisit each of the 24 defenses highlighted 24 years ago; update some drafting strategies to respond to each defense; analyze which defenses remain particularly important, given case law since 1987; and augment the discussion with further suggestions about how to negotiate, draft, and administer any guaranty.

As with any other drafting or legal suggestions, the suggestions offered here must always be adjusted to take into account the circumstances of each specific transaction. All sample language offered in this article assumes the guaranty has already defined the terms “Borrower,” “Guarantor,” “Guaranty,” “Insolvency Proceeding,” “Lender,” “Loan,” “Loan Documents,” and “Obligations.” Anyone using sample language, from this article or anywhere else, always must confirm such assumptions and edit accordingly — just one obvious example of why and how one cannot merely shovel words from one wordpile to another when using someone else’s sample language. The suggestions in this article look at the world from a lender’s perspective and do not consider how a guarantor or borrower might seek to push back against, or fine-tune, the language offered here. As a final caveat, the outcome of any particular dispute will depend on the facts of that case and the discretion of the particular court. Thus, nothing is assured.

**Defense 1: Lack Of An Enforceable Guaranty**

A guarantor’s first defense consists of a general “meeting of the minds” defense, grounded in basic contract law. It is the guarantor’s most fundamental defense, based on the theory that the transaction lacked enough mutual assent and agreement to form an enforceable contract. This defense rarely succeeds for sophisticated corporate (or other business entity) guarantors. For an individual guarantor, particularly if “unsophisticated,” it can carry more weight. If the individual does not engage separate counsel — whether by strategy or happenstance — that may also support the argument for lack of sophistication.

**Drafting tip:** Write the guaranty in plain English. Make sure the guarantor receives a copy of the guaranty, and acknowledges that. Finally, give the guarantor an opportunity to review the agreement and ask ques-
tions, as the language in many guaranties is often archaic and incomprehensible to mere mortals. Consider having the guarantor acknowledge representation by counsel.

**Sample Language:** “Guarantor acknowledges that before executing this Guaranty: (a) Guarantor has had the opportunity to review it with counsel of Guarantor’s choice; (b) Lender has recommended that Guarantor obtain separate counsel, independent of Borrower’s counsel, for this Guaranty; and (c) Guarantor has carefully read this Guaranty and understood the meaning and effect of its terms.”

**Defense 2: No Consideration**

Any guaranty, almost by definition, invites the guarantor to claim lack of consideration as a defense. That’s because the guarantor does not receive loan proceeds directly — i.e., the guarantor receives no direct benefit for signing the guaranty. Or at least it looks that way, to anyone who just looks at the surface of the transaction and tries not to think too hard.

Courts have, however, long held that a lender’s extension of credit to the primary obligor provides enough consideration for a guaranty signed at the same time. *See Jenista v. Burlington N.*, 388 N.W.2d 770, 773 (Minn. Ct. App. 1986) (guaranty supported by consideration because lender suffered detriment by extending credit to debtor). In the case of a forbearance guaranty — where a guarantor signs a guaranty of an existing loan to persuade the lender to forbear from enforcement — the “failure of consideration” defense may carry a bit more weight.

**Drafting tip:** The recitals to the guaranty should recite and substantiate delivery of consideration for the guaranty.

**Example:** “Guarantor executes and delivers this Guaranty in consideration of, and to induce, Lender’s extension of credit to Borrower. Guarantor acknowledges that Lender would not have extended such credit but for this Guaranty.”

In the usual case, in which the guarantor will in fact very much benefit from the credit to the borrower, because the guarantor owns a substantial interest in the borrower, also say:

“Guarantor will derive substantial benefits from the Loan, because Guarantor owns a substantial equity interest in Borrower.”

In the case of a forbearance guaranty, add a statement like this:

“Guarantor delivers this Guaranty to induce Lender to forbear from enforcing its rights and remedies against Borrower. That forbearance will benefit Guarantor, as a substantial equity owner of Borrower.”

At the end of the recitals, perhaps say it again:
“NOW, THEREFORE, in consideration of the foregoing recitals, and for good, adequate, and valuable consideration, receipt of which Guarantor acknowledges, Guarantor agrees....”

**Defense 3: Statute Of Frauds**

Ever since at least the original English Statute of Frauds, enacted in 1677, contracts of guaranty have needed to be in writing. Oral guaranties give guarantors a free ticket to unenforceability. Thus, no sane lender should (or would) rely on a phone call or a memorandum that is not signed by the guarantor. The validity of an email as a “writing” represents a still-developing area of the law, and no lender wants to contribute to that developmental process. If a guaranty comes from an entity, counsel should also think about issues of authority and execution, just as if the guaranty were a loan document executed by a primary borrower.

**Defense No. 4: Statute Of Limitations**

Depending on state law, the same statute of limitations that governs written agreements in general will also usually govern guaranties. But when does the clock start to tick? Usually, as soon as the underlying debt is “payable.” For a promissory note, that means the maturity date. If the lender accelerates the note, then this could accelerate commencement of the limitations period. This is one of many good reasons that lenders should act in an absolutely unambiguous and intentional way in dealing with any acceleration or rescission of acceleration.

In the rare case of a note payable on demand, the clock starts ticking as soon as the primary borrower executes the note, as if the lender were deemed to have immediately called the loan. See J.A. Bock, Annotation, *When Statute of Limitations Begins to Run Against Note Payable on Demand*, 71 A.L.R.2d 284 (1960). Thus, for demand notes, the lender may need to have the guaranty re-executed or at least reaffirmed periodically — well before the statute of limitations runs — so the lender can call the loan and enforce the note and guaranty if the guarantor decides not to cooperate.

If murky events or circumstances might give the borrower or guarantor an argument that the loan matured, the lender should “do something” before the limitations period passes — either commence enforcement, or unambiguously and bindingly extend the maturity date, or take other steps to protect its position.

Guaranties sometimes include a waiver of the statute of limitations, but nobody has much confidence in these waivers. Hence this article does not offer sample language for such a waiver. As a creative variation, a guaranty could require the guarantor, as a separate obligation, to give the lender a warning notice if the guarantor thinks the limitations period has started to run — or is about to run — as a way to perhaps bootstrap a new limitations period. Such provisions are, however, not common and probably add no more value than an outright waiver. They’re creative, though.

**Drafting tip:** Any guaranty should require that the guarantor, promptly upon request, deliver an estoppel certificate to confirm the guarantor’s continuing liability. For example, the guaranty could say:

“Guarantor shall, within ten days after Lender’s request, deliver to Lender a certificate, in form and substance reasonably satisfactory to Lender, confirming that: (a) this Guaranty remains in full force and effect