

An Annotated Guaranty

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The Restatement (Third) of Suretyship and Guaranty can be an invaluable guide to drafting an airtight loan guaranty.

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AFTER A LENDER OBTAINS A GUARANTY as additional security for a note, it will put that guaranty away in a safe place, hoping that it will never have to see it again. If a default does occur under the note and the lender is compelled to decide what remedies to pursue, it will presume that the language in the guaranty will ensure the fullest recovery permitted by law. As counsel for the lender, you must ensure that that presumption is justified. But how?

The key provisions in a lender's form of guaranty should reflect the successes and failures of suretyship defenses as they have been chronicled in cases decided under common law and Article 3 of the Uniform Commercial Code. What insight into suretyship defenses can the *Restatement (Third) of Suretyship and Guaranty* (1996), as a model whose roots are found in common law and statute, provide to lender's counsel in drafting a guaranty that will best preserve the lender's rights of enforcement under its guaranty in the face of the various suretyship defenses that may be asserted? The Annotated Guaranty below is a practical answer to this question.

Appendix A

Annotated Guaranty

THIS GUARANTY, made this ___ day of _____ 20 , by ("*Guarantor*"), having its principal address at _____.

[Note that if an individual Borrower has qualified for the Loan, requiring Borrower's spouse to sign this Guaranty *solely* because of the spouse's marital relationship with the Borrower is a violation of the Equal Credit Opportunity Act, 15 U.S.C. §1691(a); Reg. B, 12 C.F.R. § 202.7(d) (2001), and can subject the Lender to a claim for punitive damages even when actual damages cannot be demonstrated. *See Eure v. Jefferson Nat. Bank*, 448 S.E. 2d 417 (Va. 1994) and *Anderson v. United Finance Co.*, 666 F.2d 1274, 1278 (9th Cir. 1982).]

WITNESSETH:

A. _____ ("*Borrower*") is the owner in fee of certain real estate situated at _____ (the "*Real Estate*").

B. Borrower has requested _____, a ("*Lender*"), having a business office at _____, to lend it a certain sum of money.

C. Borrower has executed and delivered to Lender a Note in the

amount of Dollars (\$____), secured by a Mortgage and Security Agreement on the Real Estate, together with certain other documents evidencing and securing the loan. The Note, Mortgage, and Security Agreement and other documents are sometimes hereinafter collectively referred to as the "Loan Documents."

D. Lender has agreed to lend such sum to Borrower in consideration, among other things, of the covenants and obligations made and assumed by Guarantor as in this Guaranty set forth.

E. Guarantor has a direct financial interest in Borrower and will benefit directly from the making of the Loan to Borrower.

[The inclusion of this acknowledgment would, unless the Guarantor demonstrates prejudice caused by impairment of recourse or circumstances making the amount of loss difficult to calculate, allocate to Guarantor the burden of persuasion as to loss or prejudice caused by Lender's act. Additionally, this would support lender's argument that the relationship between Borrower and Guarantor is such that consent by the Borrower to acts of the Lender that might result in a discharge of Guarantor's obligations to Lender is, in effect, a consent to such acts by Guarantor and therefore Guarantor's liability remains intact. *See* sections 48(2) and 49(2)(a)(i) *Restatement of Suretyship*. Comment c to section 48 addresses the "imputed consent" that is intended by section 48 on grounds of fairness and reasonableness, noting that when the secondary obligor either controls the principal obligor or deals with the obligee on behalf of the principal obligor, it would be inequitable to the obligee if the principal obligor's agreement to an act by the obligee resulted in a discharge of the secondary obligor; moreover, "[I]t is reasonable for the obligee to assume that when the secondary obligor, acting on behalf of the principal obligor, agrees to an act, the secondary obligor is also agreeing to that act in its capacity as secondary obligor." Section 49 of the Restatement is generally consistent with UCC §3-605(c) and (d) in recognizing the difference in bargaining positions between guarantors who are "professional" or in the business of being sureties from those who are not (that is, the historical guarantor who gave his or her pledge out of love and affection) and how the former guarantors should not be able to obtain a windfall from the creditor where the modification to the guarantor's obligation is non-material.]

NOW, THEREFORE, for good and valuable consideration, intending to be legally bound by the provisions of this Agreement, Guarantor irrevocably and unconditionally agrees as follows:

1. Guarantor guarantees the punctual performance of all of Borrower's obligations to Lender, including, without limitation, the payment of all monetary sums due under the terms of the Note and the other Loan Documents, and any subsequent amendments, extensions, or consolidations of those terms. The term "all monetary sums due under the terms of the Note and other Loan Documents," as used in the preceding sentence shall include, but not be limited to (a) the

payment of interest at the Default Rate (as defined in the Note), and (b) payment of interest accruing on the Note or advances made under the Note regardless of whether such interest accrued or advances were made after the filing of any petition by or against Borrower under Federal or state bankruptcy laws. The amount of this Guaranty is unlimited.

2. Guarantor waives any right to notice of advances made to Borrower from time to time under the provisions of the Loan Documents, waives any rights Guarantor may have by reason of any forbearance, modification, waiver, or renewal or extension that Lender may grant, or to which Lender and Borrower may agree, with respect to the Loan Documents, waives notice of acceptance of this Guaranty, and waives presentment, demand, notice, or protest of any kind.

[Is it enough to say simply that Guarantor waives all surety defenses without listing specific waivers? Does the Guarantor's relationship to the Borrower influence the decision on inclusion of this language? Query whether a Lender should ever omit to copy Guarantor on notices sent to Borrower as a matter of prudent practice. Does Lender owe any kind of fiduciary duty to Guarantor? See *Manufacturers Hanover Trust Co. v. Yanakas*, 7 F.3d 310, 318 (2d Cir. 1993); *Village on Canon v. Bankers Trust Co.*, 920 F. Supp. 520 (S.D.N.Y. 1996); *Miller v. U.S. Bank of Washington*, 72 Wash. App. 416, 865 P.2d 536 (Wash. Ct. App. 1994) (holding that a bank owes no duty of a fiduciary nature to a guarantor) and *John D. Warner, Jr., et al. v. Lewis H. Clementson*, 492 S.E.2d 655, 657 (Va. 1997) (in holding that no fiduciary duty is owed to a guarantor by a trustee under a deed of trust, the Virginia Supreme Court noted that "a guarantor is ordinarily not a party to a deed of trust, and often a trustee does not know whether a guarantor even exists.") *But see First NH Mortg. Corp. v. Greene*, 653 A.2d 1076, 1078 (N.H. 1995) which recognized a fiduciary duty by a mortgagee to the guarantor but indicated that a breach of that fiduciary duty may be used by guarantor for defensive purposes only, holding that where a breach of the fiduciary duty owed a guarantor or mortgagor by a mortgagee is the result of affirmative negligence, the defense of commercial unreasonableness cannot be waived. Is it enough to say simply that Guarantor waives all surety defenses without listing specific waivers? Does the Guarantor's relationship to the Borrower influence the decision on inclusion this language? Query whether a Lender should ever omit to copy Guarantor on notices sent to Borrower as a matter of prudent practice. The obligations of Guarantor under this Guaranty are *primary, absolute, independent, irrevocable and unconditional* Query whether the underscored language is enough to circumvent the need for the language in Paragraphs 2, 4, 5 and 6 of this Guaranty...,(emphasis underscored) Is the phrase "unconditional guarantee" sufficient by itself to result in a waiver of suretyship defenses. See section 48(1) of *Restatement of Suretyship* which provides in part, "Such...waiver, if express, may be effectuated by specific language or by general language indicating that the secondary obligor waives defenses based on suretyship." The *Restatement* goes on to provide in

Comment d to section 48: “Some indication that suretyship rights are being foregone is required; thus, a statement to the effect that the duty of the secondary obligor is absolute or unconditional is ordinarily not sufficient to indicate that the secondary obligor is agreeing to forego discharges based on suretyship status....General language indicating that the secondary obligor waives defense based on suretyship is sufficient. The secondary obligor need not waive separately each ground for discharge, nor must the contract describe them.” *See also* subsection (i) of UCC §3-605 (which section replaces former section 3-606) which allows waiver of defense of impairment of collateral, either specifically by general language waiving suretyship defenses or defense of impairment of collateral, *but see further* Comment 8 to UCC § 3-605 which notes that if an accommodation party is a debtor with respect to a note secured by personal property collateral, Article 9 also applies, including as to whether and to the extent the debtor’s rights under Article 9 can be waived. This Guaranty shall be an agreement of suretyship as well as of guaranty. Lender may proceed directly against Guarantor whenever Borrower fails to make any payment when due, or otherwise fails to perform any obligation now or hereafter owed to Lender without being required to proceed first against Borrower or any other person or entity, or against the Real Estate pursuant to the Mortgage or against any other security for Borrower’s obligations to Lender. This is to make clear that this is a guaranty of payment instead of merely a guaranty of collection. In Pennsylvania, a guaranty is deemed to be an agreement of suretyship unless it expressly states that it is a guaranty of collection. Pa. Stat. Ann. tit. §1 (West 1999): *Every written agreement hereafter made by one person to answer for the default of another shall subject such person to the liabilities of suretyship, and shall confer upon him the rights incident thereto, unless such agreement shall contain in substance the words: “This is not intended to be contract of suretyship,” or unless each portion of such agreement intended to modify the rights and liabilities of suretyship shall contain in substance the words: “This portion of the agreement is not intended to impose the liability of suretyship.”* Is there a difference between the two in the ability to assert suretyship defenses? *See United States v. Shirman*, 41 F.R.D. 368, 373 (N.D.Ill. 1966) which, in granting summary judgment, held that [a] guarantor of payment, as distinguished from a guarantor of collection, cannot avail himself of the defense that the creditor through negligence, or the lack of due diligence, lost or dissipated the collateral furnished by the debtor.”]

3. All payments by Guarantor to Lender shall be paid in lawful money of the United States of America and shall be payable without set-off, deduction, or counterclaim.

[With a global economy and the increase in incidents of having foreign parent company guarantors, it is important to denote the currency that governs the Guarantor’s obligations. Does common law require Guarantor to specifically waive its right to claim impairment of collateral as a defense? *See Istituto Mobiliare Italiano, S.p.A. v. Motorola, Inc.*, 689 F. Supp. 812, 817 (N.D. Ill. 1988), where the District Court observed