

The Transactional Lawyer

A Publication of the Commercial Law Center



Revival Clauses in Guarantees: Protecting the Creditor from Preference and Fraudulent Transfer Risk

Stephen L. Sepinuck

It is axiomatic that full payment of a guaranteed obligation discharges the surety. However, well-drafted guaranty agreements often contain a clause that purports to revive the surety’s obligation if the payment is an avoidable preference or fraudulent transfer and the creditor is required to return the payment. Are such clauses necessary or are they merely an example of the excessive caution so often displayed by transactional attorneys? Well, the answer may be both. Such clauses are not needed to revive the surety’s obligation if the creditor has repaid or returned the avoidable transfer pursuant to a court order. However, a well-drafted clause *may* be needed to revive the surety’s obligation if the creditor repays pursuant to a settlement.

If the principal obligor or the surety pays a guaranteed obligation and the creditor later returns the payment pursuant to “a legal duty to do so,” then the surety’s secondary obligation automatically revives. See Restatement (Third) of Suretyship & Guaranty § 70 (1996); Restatement of Security § 115(2) (1941). The few cases on this issue are uniformly in accord. See *In re Herman Cantor Corp.*, [15 B.R. 747](#) (Bankr. D. Vt. 1981); *Horner v. First National Bank of St. Mary’s*, [141 S.E. 767](#) (Va. 1928); *Jones v. Laramore*, [102 S.E. 526](#) (Ga. 1920); *Wright v. Gansevoort Bank*,

[103 N.Y.S. 548](#) (N.Y. App. Div. 1907); *Hooker v. Blount*, [97 S.W. 1083](#) (Tex. Ct. App. 1906); *Swarts v. Fourth National Bank*, [117 F. 1](#) (8th Cir. 1902); *Northern Bank of Kentucky v. Farmers’ National Bank*, [63 S.W. 604](#) (Ky. Ct. App. 1901). Cf. *In re Express Liquors, Inc.*, [65 B.R. 952](#) (Bankr. D. Md. 1986) (guarantors’ obligation not revived because they entered into a novation after the transfers were made but before they were avoided).

However, if the creditor voluntarily returns the payment, the surety’s obligation does not automatically revive. See Restatement (Third) of Suretyship & Guaranty § 70 cmt. c; Restatement of Security § 115(2) cmt. f. Thus, for example, if the creditor returns all or a portion of a payment in settlement of a preference claim, then the surety may be permitted – absent language in the guaranty agreement to the contrary – to contest whether payment was really avoidable and thus whether the creditor had liability for it. See *In re Actrade Financial Technologies, Ltd.*, [2009 WL 2929440](#) (Bankr. S.D.N.Y. 2009).

This is not to say that return of the payment in settlement of a preference or fraudulent transfer action is or should be treated as voluntary. For example, in *In re SNTL Corp.*, [571 F.3d 826](#) (9th Cir. 2009), a creditor returned a \$110 million payment pursuant to a court-approved settlement of a preference action. The creditor then sought to collect from the surety pursuant to a clause in the guaranty providing that “[i]n the event that any court of competent jurisdiction . . . enters a final order . . . [that] payment of all or any part of the [debt] . . . constitutes a voidable or preferential transfer,” then the creditor may exercise “any other remedy provided by law.” The surety argued that settlement was voluntary and thus the creditor was not entitled to revive the guaranty under the law. The Ninth Circuit disagreed, concluding that the creditor’s position was “more persuasive because it does not require full and costly litigation” to the bitter end. *Id.* at 836-37 (citing *Wallace Hardware Co., Inc. v. Abrams*, [223 F.3d 382](#) (6th Cir. 2000)).

Still, it may be advisable to have a clause in the guaranty agreement to address this issue. After all, the contract clause in *SNTL* was triggered by the court’s approval of the settlement, which expressly provided that the payment was on account of the claimed preferential transfers, not on account of any tort claims. If the creditor returns the payment pursuant to a

Contents	
<i>Revival Clauses in Guarantees: Protecting the Creditor from Preference and Fraudulent Transfer Risk</i>	1
<i>Multiple Documents, One Contract?</i>	2
Recent Cases	3
Recent Client Alerts	4

settlement that is not judicially approved, say perhaps because no avoidance complaint was ever filed, the surety may have room to argue that the repayment was voluntary. The following clause should protect the creditor.

Revival and Reinstatement.

If Creditor repays, restores, or returns, in whole or in part, any payment or property previously paid or transferred to Creditor in full or partial satisfaction of any Guaranteed Obligation [or an obligation of Guarantor under this Agreement], because the payment or transfer, or the incurrence of the obligation so satisfied, is declared to be void, voidable, or otherwise recoverable under any state or federal law (collectively, a “Voidable Transfer”), or because Creditor elects to do so on the reasonable advice of its counsel in connection with an assertion that the payment, transfer, or incurrence is a Voidable Transfer, then, as to any such Voidable Transfer, or the amount thereof that Creditor repays, restores, or returns, and as to all reasonable costs, expenses, and attorney’s fees of Creditor related thereto, the liability of Guarantor will automatically and immediately be revived, reinstated, and restored and will exist as though the Voidable Transfer had never been made.

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Multiple Documents, One Contract?

Linda J. Rusch

A recent case out of Florida raises an important consideration regarding contract drafting that could surprise parties that execute multiple documents as part of one transaction. In *MV Insurance Consultants, LLC v. NAFH National Bank*, [2012 WL 1414838](#) (Fla. Ct. App. 2012), the parties executed several documents in connection with a \$750,000 loan. When the bank sued

the borrower for breach for failure to repay the loan, the borrower sued to compel arbitration for all the claims. The arbitration clause was contained in only of the documents (titled “Collateral Assignment of Termination Payments and Economic Interests Agreement”), and provided that any dispute “arising out of or relation to this Agreement or to any portion thereof shall be settled by arbitration.” The bank’s complaint also stated claims for breach of the terms of three other documents, a “Promissory Note,” a “Security Agreement,” and a “Guaranty,” that were all executed at the same time as the “Collateral Assignment” document.

The appellate court ordered arbitration as to all the claims under the Collateral Assignment, Promissory Note, and Security Agreement, because each was executed at the same time and each contained language suggesting that the remedies provided in one document could be used if there was a breach of the terms in another document. The appellate court also relied on the general principle that documents executed contemporaneously and in regard to the same transaction should be construed together as one contract. *Cf.* Cal. Civ. Code § 1642 (“Several contracts relating to the same matters, between the same parties, and made as parts of substantially one transaction, are to be taken together.”)

What is surprising about this case, however, is that the court also used this general principle to order arbitration of the claim arising out of the guaranty document, even though the guarantors were not the primary obligor and had not executed the other loan documents, and the guaranty did not contain a reference to the remedies available under the other documents. The court did not seem to notice these important points. In fact, many courts do not treat guarantors as bound by a choice-of-law, choice-of-forum, or jury waiver clause in a loan agreement or promissory note if the clause is not also contained in the guaranty agreement. *See, e.g., Textron Financial Corp. v. Ship and Sail, Inc.*, [2011 WL 344134](#) (D.R.I. 2011) (jury waiver); *Freestone Capital Partners L.P. v. MKA Real Estate Opportunity Fund I, LLC*, [230 P.3d 625](#) (Wash. Ct. App. 2010) (choice of law); *Jetstream of Houston, Inc. v. Aqua Pro Inc.*, [2010 WL 669458](#) (N.D. Ill. 2010) (forum selection); *Long John Silver’s, Inc. v. DIWA III, Inc.*, [650 F. Supp. 2d 612](#) (E.D. Ky. 2009) (choice of forum and consent to jurisdiction). There is, however, some contrary authority. *See, e.g., Groth Family Limited Partnership v. TD Bank*, [2011 WL 6268423](#) (Conn. Super. Ct. 2011) (jury waiver); *Regions Bank v. Weber*, [2010 WL 5121074](#) (La. Ct. App. 2010) (arbitration).

The moral of this short case is simple. When drafting and executing multiple documents as part of one transaction, pay close attention to the remedies and default clauses in all the documents and any general references to the other documentation. This is particularly important if all the parties to all of the documents are not the same parties.

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Recent Cases

SECURED TRANSACTIONS

Bank of America v. Ledgercare, Inc.,

[2012 WL 1591800](#) (Conn. Super. Ct. 2012)

Security agreement executed in 2002 to secure obligation on mortgage also did not cover indebtedness under 2007 line of credit despite language in security agreement purporting to cover “all indebtedness and obligations now or hereafter owing from the Debtor to the Bank of whatever kind or nature, whether presently existing or hereafter arising” because the security agreement predated the note and mortgage and the reference to future debt was necessary to cover that transaction, not the line of credit.

Variety Wholesalers, Inc. v. Salem Logistics Traffic Services, LLC,

[723 S.E.2d 744](#) (N.C. 2012)

Whether security interest granted by freight bill processor attached to the funds provided to the processor by its clients was a question of fact not appropriate for summary judgment with respect to clients’ claim for conversion against the secured party.

Oxford St. Props., LLC v. Rehabilitation Assocs., LLC,

[2012 WL 1861119](#) (Cal. Ct. App. 2012)

Bank did not have a security interest in deposit accounts holding some of the proceeds of its refinancing loan to the debtor because the funds were earmarked to pay off a previous partner, not as security for the loan, and the debtor did not have sufficient rights in the deposit accounts to grant a security interest in them. In addition, the security agreement covered only those “deposit accounts . . . arising out of, or relating to, the acquisition, development, ownership,

management or use of” certain real property, and the deposit accounts in question were not such accounts.

Jorday, Inc. v. Burggraff,

[2012 WL 1813436](#) (Minn. Ct. App. 2012)

Bank did not acquire a security interest in amusement park equipment from newly formed corporation because even though the corporation later claimed depreciation allowance for the equipment on its tax return and the principals of the corporation represented that the corporation had acquired the equipment from the trust that had purchased it, and which they also controlled, there was no bill of sale or other document of conveyance from the trust to the corporation.

Epps v. JP Morgan Chase Bank,

[675 F.3d 315](#) (4th Cir. 2012)

The National Bank Act and the OCC regulations promulgated thereunder preempt, with respect to national banks, state laws requiring disclosures relating to an extension of credit, not notices relating to debt collection, and thus do not preempt Maryland law requiring secured parties to provide certain detailed information to the debtor after repossession of tangible personal property.

In re Jundanian,

[2012 WL 1098544](#) (Bankr. D. Md. 2012)

Debtor’s membership and distribution rights in Maryland LLC became part of his bankruptcy estate but nothing in the Bankruptcy Code overrode the restrictions on transfer of the membership rights; thus the trustee’s sale to the debtor included only the distribution rights and the debtor did not re-acquire rights as member to participate in the management of the LLC.

BANKRUPTCY

In re TOUSA, Inc.,

[2012 WL 1673910](#) (11th Cir. 2012)

Lenders that shortly before bankruptcy were paid off with the proceeds of a new loan secured by subsidiaries’ assets received a fraudulent transfer because they were entities for whose benefit the liens were transferred and, even if the opportunity to avoid default and bankruptcy constitutes “value” for this purpose, this value was not reasonably equivalent to what they transferred.

GUARANTIES & RELATED MATTERS

MB Financial Bank v. Paragon Mortg. Holdings, LLC,
[2012 WL 933598](#) (Fla. Ct. App. 2012)

Transfer of senior loan to newly formed entity owned by two of the four guarantors did not operate as a payment of the senior loan and thus did not terminate the subordination agreement and its standstill provision. Language in the subordination agreement providing for the senior loan to be paid in full before any payment was made “by or on behalf of” the debtor did not prevent the junior lender from obtaining a judgment against the guarantors, although it prevented enforcement of the judgment until the senior loan was paid in full.

Eagerton v. Vision Bank,
[2012 WL 1139148](#) (Ala. 2012)

Consolidation of two loans in debtor’s bankruptcy that did not alter the interest rate of the first loan or change the collateral for either discharged the guarantors of the first loan even though the guaranty agreement covered extensions, renewals, and replacements of that loan and waived “any and all defenses . . . pertaining to Indebtedness” because the consolidation increased the amount of the debt. It did not matter that the creditor sought to allocate foreclosure proceeds proportionally.

LENDING, CONTRACTING & COMMERCIAL LITIGATION

Retirement Board of the Policemen’s Annuity & Benefit Fund v. Bank of New York Mellon,
[2012 WL 1108533](#) (S.D.N.Y. 2012)

Certificates issued under a pooling and servicing agreement for mortgage-backed securities are debt, not equity, and are therefore subject to the Trust Indenture Act. Investors stated claim against indenture trustee for failing to require the master servicer to cure, substitute, or repurchase defective loans.

MV Insurance Consultants v. NAFH National Bank,
[2012 WL 1414838](#) (Fla. Ct. App. 2012)

Because agreements executed contemporaneously by the same parties and concerning the same transaction are construed together as a single contract, arbitration clause in the parties’ Collateral Assignment of Termination Payments and Economic Interests applied to claims brought under the promissory note, security agreement, and guaranty.



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