

# The Transactional Lawyer

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## Suggestions for Drafting Guaranties

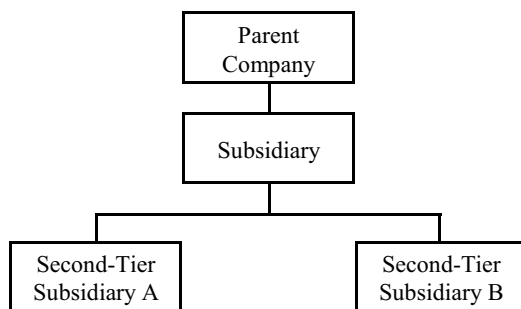
**Stephen L. Sepinuck**

Most commercial lawyers will attest that guarantors are a litigious group. They rarely voluntarily and promptly pay after the principal obligor defaults, and instead raise every conceivable defense and counterclaim that clever legal minds can devise. Consequently, transactional lawyers need to be extremely careful in how they structure and draft guaranty agreements. This article offers nine suggestions to lawyers engaged in that activity. Most of these suggestions are derived from recent cases that might have been resolved more readily had those involved heeded the suggestions.

### STRUCTURING THE TRANSACTION

#### 1. Downstream, Not Upstream or Cross-stream

At the inception of most loan transactions, the identity of the borrower and the guarantors is known and not subject to negotiation. Occasionally, however, there is some flexibility when lending to affiliated entities. When that is true, there should be a strong preference for lending to one or more of the entities at the bottom of the organizational structure, with each of the others providing a guaranty. For example, putting all other considerations aside, the loan should be made to either or both of the Second Tier Subsidiaries in the following diagram:



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The reason for this is that it reduces the risk that one or more of the guaranties will be avoidable under the Uniform Voidable Transactions Act or one of its predecessors, the Uniform Fraudulent Transfer Act and the Uniform Fraudulent Conveyances Act. Those laws, one of which is in effect in almost every state, make avoidable the incurring of an obligation if the obligor is insolvent (or is thereby rendered insolvent) and does not receive reasonably equivalent value in exchange.<sup>1</sup> Hence, any guaranty executed by an insolvent entity that receives no measurable benefit therefor can be avoided.

However, the benefit need not be in cash or property and it need not be direct.<sup>2</sup> Accordingly, when a parent company guarantees a loan made to a subsidiary (a “downstream guaranty”), the parent is generally benefitted by the fact that its subsidiary receives the loan.<sup>3</sup> In contrast, it is much more difficult to identify a benefit to a subsidiary that guarantees a loan to a parent (an “upstream guaranty”) or to another subsidiary (a “cross-stream guaranty”).<sup>4</sup> So, to reduce the risk of avoidance if the guarantor is later shown to have been insolvent on the date that the guaranty was entered into, guaranty down, not up or sideways.

#### 2. Execute at the Loan Closing, Not Later

It is not uncommon for a guarantor to claim that a guaranty is unenforceable due to a lack of consideration. Most such arguments, based on the fact that the guarantor received no payment or other benefit for the guaranty, are baseless.<sup>5</sup> After all, consideration is classically defined as bargained-for benefit to the promisor (in this case, the guarantor) or detriment to the promisee (the lender).<sup>6</sup> The lender suffers a detriment by making the loan to the borrower, and this is in the normal course of events all the consideration needed for a guaranty, even though the guarantor receives nothing.

A problem can arise, however, if for some reason the guaranty is not signed at the loan closing at which the funds are advanced and is, instead, provided later. In such a case, it is at least arguable that the loan cannot serve as consideration for the later guaranty.<sup>7</sup> To be sure, there are cases indicating that if the parties understood at the time the loan was made that an additional guaranty would be provided, the loan is adequate consideration for the guaranty.<sup>8</sup> However, not all jurisdictions might be so accommodating. Thus, if it is necessary to close without

a required guaranty, then one or more of the documents should make execution and delivery of the guaranty a post-closing covenant and the failure to provide it an event of default (*i.e.*, a condition to the exercise of default remedies). That way, providing the guaranty later would be supported by consideration (*i.e.*, the creditor's forbearance).<sup>9</sup>

### THE LANGUAGE OF THE GUARANTY

Traditionally, and for reasons that might be quaint and no longer comport with modern commercial law or practices, a guarantor is a "favorite of the law," and a guaranty agreement is strictly construed against the creditor.<sup>10</sup> Consequently, while transactional lawyers always need to keep ambiguity out of the documents they draft, it is especially important to avoid ambiguity that might impair the enforceability or scope of a guaranty.

#### 3. *Cap Liability Rather than Guarantee a Portion of the Debt*

If the parties intend that a guarantor not be responsible for the principal obligor's maximum liability, they can structure that limitation in either of two ways: (i) by capping the amount of the guarantor's liability; or (ii) by having the guarantor cover a specified portion or percentage of the principal obligor's obligation. From the creditor's perspective, the former is clearly preferable and the latter should be avoided at all costs.

If a guarantor promises to be responsible for only a portion of the debt – so that there is a guaranteed portion of the debt and a non-guaranteed portion – then disputes will likely arise about to which obligation – the guaranteed obligation or the non-guaranteed obligation – payments from the principal obligor and proceeds of collateral are to be allocated.<sup>11</sup> Even if the creditor ultimately prevails, these issues can be difficult and expensive to resolve. In contrast, a cap on liability is not ambiguous and does not create an interpretive problem.<sup>12</sup>

That said, it is worth noting that allocation problems can arise for other reasons. For example, if a continuing guaranty is terminated, the guarantor remains secondarily liable for obligations incurred before termination but has no liability for obligations incurred afterwards. Moreover, any principal obligor whose debt is guaranteed might subsequently incur an unrelated, non-guaranteed obligation to the creditor. To deal with this possibility, a guaranty agreement should expressly indicate to which obligations the creditor may or must allocate payments received from the principal obligor and proceeds of collateral.<sup>13</sup>

#### 4. *Cover All Obligations and All Transaction Documents*

Often, the underlying obligation will extend beyond the payment of the principal and interest on a loan or the purchase price of property sold. It is important to make sure that the guaranty agreement covers whatever those additional obligations are. This suggestion is similar to the prior point but goes beyond it.

For example, in one recent case, a promissory note made the principal obligor responsible for the attorney's fees the creditor incurred in attempting to collect. However, the guaranty was limited to "principal and interest" on the note. The court ruled that the guarantor was not liable for the attorney's fees that the creditor incurred in attempting to enforce the note against the principal obligor or the collateral.<sup>14</sup>

Similarly, in a case from earlier this year, the owners of a motorcycle dealership sold the dealership on credit, receiving a promissory note in return. In connection with the transaction, the buyer also leased the real property on which the dealership was located, executed consulting agreements with the former owners, and entered into a noncompete agreement with the former owners. The buyer had monetary obligations under all the documents but the guaranty covered only the promissory note and the lease. The court ruled that the buyer's obligations under the consulting agreements and the noncompete agreement – which composed more than 40% of the buyer's total liability – were not guaranteed.<sup>15</sup>

So, it is important to cover all of the principal obligor's liability to the creditor. That said, transactional lawyers can go astray in purporting to cover all modifications of the underlying obligation. In one case, a guaranty agreement signed by the sole shareholders of a corporation defined the indebtedness as all obligations of the corporation and any advances or transactions that "modify, refinance, consolidate or substitute" those debts, whether "voluntarily or involuntarily incurred." The corporation sought bankruptcy protection and its obligation to the creditor was reduced pursuant to a confirmed Chapter 11 plan. The court ruled that this modification reduced the claim against the guarantors.<sup>16</sup>

#### 5. *Waive Suretyship Defenses*

As a favorite of the law, a guarantor is accorded a variety of defenses to payment. These suretyship defenses generally cover almost anything that increases the guarantor's risk or cost of performance or decreases the guarantor's ability to cause the principal obligor to bear the cost of performance, and specifically include:

- Releasing the principal obligor from a duty to pay money or other obligation;
- Granting the principal obligor an extension of time to perform;
- Agreeing to some other modification of the duties of the principal obligor;
- Impairing the value of an interest in collateral securing the principal obligation;
- Allowing the statute of limitations on the principal obligation to expire; and
- Doing anything else that impairs the guarantor's rights of restitution or subrogation.<sup>17</sup>

A guarantor can waive these suretyship defenses at the outset of a transaction and many commercial lenders routinely include waiver language in their form guaranty agreements. Often, the language lists each suretyship defense waived, which lengthens the agreement and, more importantly, increases the risk that one or more suretyship defenses might be unintentionally omitted.

Fortunately, most suretyship defenses can be waived with a general statement that does not expressly list each defense and instead simply indicates that the guarantor is waiving all defenses based on suretyship.<sup>18</sup> The following language should be effective:

**Guarantor waives all suretyship defenses.**

Transactional lawyers should be aware, however, that some defenses might not be waived by such general language.<sup>19</sup> As a [prior article](#) in this newsletter discussed, a defense based on the lender's unclean hands might not be covered by a general waiver of suretyship defenses.<sup>20</sup> Similarly, a general waiver of suretyship defenses might not cover a breach of the creditor's duty of good faith, including its obligation – prior to extending additional credit – to disclose to a guarantor that has provided a continuing guaranty any fact known to the creditor that materially increases the guarantor's risk.<sup>21</sup> However, it should be possible to negate such a duty of disclosure entirely by expressly disclaiming it in the agreement. Language such as the following should be effective:

**Guarantor represents and warrants that Guarantor has adequate means to obtain all relevant information, on a continuing basis, concerning Borrower's financial condition and Borrower's ability to perform its obligations under the Loan Documents. Guarantor is responsible for being and keeping informed of Borrower's financial condition and of all circumstances bearing upon the risk of nonpayment of the Guaranteed Obligations.**

**Guarantor hereby waives any duty of Creditor to disclose any information, now or hereafter known by Creditor, which relates to the financial condition of Borrower or Guarantor's risk under this Guaranty.**

## 6. Waive Contract Law Defenses

Because a guarantor promises to perform the principal obligor's duties, it follows logically that if the principal obligor has no duties, then neither does the guarantor. More broadly, if the principal obligor has a defense against the creditor that makes the principal obligation unenforceable, then the guarantor too would normally be absolved.

However, a guaranty agreement – at least one between sophisticated parties – can provide that it will be enforceable even if the borrower's obligation on the underlying obligation is not. Note, language merely waiving "suretyship defenses" will likely not be adequate for this purpose.<sup>22</sup> Instead, language such as the following is needed:

**Guarantor's liability under this Guaranty is absolute and irrespective of any lack of validity or unenforceability of the Loan Documents or of Borrower's liability for the Guaranteed Obligations. Guarantor waives all defenses to liability hereunder, and any counterclaim or right of setoff, that Guarantor has now or hereafter acquires.**

Such language is apparently effective to bind the guarantor even if:

- The borrower lacked authority to enter into the transaction<sup>23</sup>;
- The borrower failed to sign the transaction documents<sup>24</sup>;
- The underlying obligation is an unenforceable penalty<sup>25</sup>;
- The loan is usurious<sup>26</sup>;
- The creditor caused the borrower's default<sup>27</sup> or otherwise acted in bad faith<sup>28</sup>; or
- The underlying transaction was procured through fraudulent inducement.<sup>29</sup>

Indeed, a guaranty agreement can, apparently, also waive the guarantor's own contract law defenses, such as fraudulent inducement.<sup>30</sup> This is a bit curious. After all, if the guaranty agreement was procured through a type of fraud that would render an agreement avoidable, then the waiver in the guaranty agreement would seem avoidable

as well. Nevertheless, courts do not seem to distinguish between fraudulent inducement of the underlying transaction and fraudulent inducement of the guaranty, either because the two are usually intertwined or because they have simply failed to consider the issue.

It is worth noting what waiver language such as that recommended in suggestion 3 above will not do. First, of course, it will not waive a defense that the underlying obligation has been satisfied.<sup>31</sup> Second, in some jurisdictions, it will not waive a defense of lack of consideration for the guaranty.<sup>32</sup> Third, it might also not waive claims based on unrelated conduct of the creditor.<sup>33</sup> Finally, a guarantor cannot waive pre-default many of its rights under Article 9 of the U.C.C., including the right to notification of a disposition or to have a disposition conducted in a commercially reasonable manner.<sup>34</sup>

### 7. *Waive the Rights of Reimbursement and Subrogation*

In the normal course of events, a guarantor that pays any part of the guaranteed obligation has a right of reimbursement against the principal obligor and, upon total satisfaction of the guaranteed obligation, a right of subrogation, which allows it to step into the shoes of the creditor.<sup>35</sup> For a time, these rights subjected the creditor to increased preference exposure in the event of the debtor's bankruptcy. Consider the following hypothetical:

Bank makes an unsecured or undersecured loan to Corporation, guaranteed by Officer, who is the president and majority shareholder. Four months before filing for bankruptcy protection and while insolvent, Corporation repays part of the debt.

Although the payment enabled Bank to receive more than it would have in a Chapter 7 liquidation, the transfer was outside the normal 90-day preference period and thus, absent the guaranty, not avoidable.<sup>36</sup> However, the payment also benefitted Officer by reducing Officer's liability on the guaranty. Officer is a creditor of Corporation because Officer has a contingent, common-law right to be reimbursed by Corporation for any payment Officer makes to Bank on Corporation's debt. Because Officer is also an insider of Corporation,<sup>37</sup> a one-year preference period applies to any transfer to or for Officer's benefit. Thus, even though Officer did not receive the transfer, the transfer to Bank is nevertheless an avoidable preference. This result was confirmed by the Seventh Circuit in *Levit v. Ingersoll Rand Financial Corp.*<sup>38</sup>

To address this problem, Congress twice amended the Bankruptcy Code. First it added § 550(c) to the Bankruptcy Code, to insulate the non-insider creditor from liability.<sup>39</sup> A decade later, Congress added § 547(i), to make it clear that the avoidance of non-monetary transfers, such as the grant of a lien, would not affect the creditor at all.<sup>40</sup>

However, these amendments did not in any way lessen the preference liability of the insider guarantor. Because of that, creditors who obtain a guaranty still can be burdened by the guarantor's rights of reimbursement and subrogation. If during the applicable preference period the debtor repaid a portion of the debt, and as a result the guarantor now has preference liability to the estate as well as liability to the creditor for the remaining amount due under the guaranty, the creditor is effectively left competing with the bankruptcy estate for the guarantor's assets. To resolve this problem, some lenders require their guarantors to waive all rights to reimbursement and subrogation. This prevents the guarantors from qualifying as "creditors" of the debtor,<sup>41</sup> and therefore any benefit they receive from the debtor's transfer to the creditor cannot be avoidable as a preference.<sup>42</sup>

### 8. *Include a Robust Revival Clause*

While on the subject of avoidable preferences, it is worth considering what happens if the principal obligation is paid in full – by either the creditor or the guarantor – but the payment is later avoided in bankruptcy. Although full payment normally discharges the guarantor, a reversal of that payment should resurrect the guaranty.

In fact, the common law generally provides for that. However, for reasons discussed in a [prior article](#) in this newsletter,<sup>43</sup> the common-law rule might not be as broad as the creditor would like it be: it definitely revives the guarantor's obligation if the creditor returns a payment pursuant to court order but *might not* revive the guarantor's obligation if the creditor returns the payment pursuant to a settlement. Accordingly, every guaranty agreement should contain language such as this:

#### **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, because the payment or transfer ("Transfer") was declared to be void, voidable, or otherwise recoverable under any state or federal law, or because Creditor elects to repay,**

**restore, or return, in whole or in part, in connection with a claim that the Transfer was void, is voidable, or is otherwise recoverable, then as to any amount that Creditor repays, restores, or returns, and as to all reasonable costs, expenses, and attorney's fees of Creditor related to the Transfer or to the repayment, restoration, return, or voidability of the Transfer, the liability of Guarantor will automatically and immediately be revived, reinstated, and restored and will exist as though the Transfer had never been made.**

### 9. *Restate in the Guaranty Boilerplate Terms in the Loan Agreement*

Most well-drafted loan agreements include a choice-of-law clause, a choice-of-forum clause, and a term making the borrower responsible for the creditor's attorney's fees. They might also make clear that the default interest rate applies post-judgment.<sup>44</sup> As discussed in two prior articles in this newsletter,<sup>45</sup> these terms might or might not be binding on the guarantor.<sup>46</sup> The terms are more likely to bind a guarantor who promises to *perform the borrower's obligations* rather than a guarantor who promises to *pay the guaranteed obligation*. However, even the broader language provides no assurance that the guarantor will be bound by such terms. Accordingly, the guaranty agreement should include its own provisions for each of these terms to ensure that the guarantor is bound by them.

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#### Notes:

1. See UVTA § 4(a)(2); UFTA § 4(a)(2). See also 11 U.S.C. § 548(a)(1)(B).
2. The leading case on upstream, downstream, and cross-stream guaranties is *In re Image Worldwide, Ltd.*, [139 F.3d 574](#) (7th Cir. 1998) (while indirect benefits can be considered in determining whether an entity received reasonably equivalent value for a guaranty of an affiliate's debt, the debtor here did not receive reasonable equivalent value for its cross-stream guaranty).
3. See *In re Lawrence Paperboard Corp.*, [76 B.R. 866](#) (Bankr. D. Mass. 1987). See also Robert J. Rosenberg, *Intercorporate Guaranties and the Law of Fraudulent Conveyances: Lender Beware*, [125 U. PA. L. REV. 235](#),

238-39 (1976) (suggesting that an upstream or cross-stream guaranty is more vulnerable to avoidance than a downstream guaranty).

4. For an example of a recent case in which a court declined to treat upstream benefit as reasonably equivalent value, see *In re UC Lofts on 4th, LLC*, [2015 WL 5209252](#) (9th Cir. BAP 2015). See also *In re Sabine Oil & Gas Corp.*, [547 B.R. 503](#) (Bankr. S.D.N.Y. 2016) (the upstream guaranties and security interests granted by insolvent subsidiaries in connection with a corporate merger were potentially avoidable fraudulent transfers even though the debt incurred by the merger survivor/parent was not).

5. See, e.g., *Tri-Town Const. Co., Inc. v. Commerce Park Assocs. 12, LLC*, [139 A.3d 467](#) (R.I. 2016); *BMO Harris Bank v. Malaszuk Specialized Logistics, LLC*, [2016 WL 1589869](#) (W.D. Wis. 2016); *Icon Agent, LLC v. Kanza Const., Inc.*, [2016 WL 197803](#) (Kan. Ct. App. 2016); *Capital City Bank v. Jones*, [775 S.E.2d 608](#) (Ga. Ct. App. 2015); *Indymac Bank v. Aryana/Olive Grove Land Dev., LLC*, [2013 WL 12129624](#) (Cal. Ct. App. 2013).

6. See, e.g., *Hamer v. Sidway*, [27 N.E. 256](#) (N.Y. 1891).

7. See, e.g., *Equipment Fin. Partners v. Rose*, [2014 WL 1917957](#) at \*5-6 (D. Or. 2014); *Helton v. Jasper Banking Co.*, [715 S.E.2d 765](#), 767 (Ga. Ct. App. 2011); *L.D.S., LLC v. Southern Cross Food, Ltd.*, [954 N.E.2d 696](#), 708-09 (Ill. Ct. App. 2011). See also *MJL Props., LLC v. Community and S. Bank*, [768 S.E.2d 111](#) (Ga. Ct. App. 2015); *RL BB ACQ II-FL LAND 360, LLC v. Macland, 360, LLC*, [2013 WL 915205](#) (E.D. Tenn. 2013); *City Nat'l Bank of Hoopston v. Russell*, [615 N.E.2d 1308](#) (Ill. Ct. App. 1993) (each dealing with consideration with respect to a renewal or extension of a loan); *In re C & K Market, Inc.*, [2015 WL 1777689](#) (D. Or. 2015) (dealing with consideration for a subordination agreement).

Louisiana, a state with a civil law tradition, does not require consideration to have an enforceable contract. See [La. Civ. Code arts. 1907, 1910](#). Instead, "cause" is needed, [La. Civ. Code art. 1967](#), but gratuity can be sufficient cause for a contract.

8. See, e.g., *Williams v. Stussy*, [2016 WL 2946178](#) (Minn. Ct. App. 2016); *FDIC v. Amos*, [2015 WL 12434211](#) (N.D. Fla. 2015).

9. A promise to forebear or to maintain a business relationship is consideration to support a guaranty of an existing obligation. See, e.g., *Scarlet Kim & Co. v. Clozell, Inc.*, [2017 WL 2727087](#) (D.N.J. 2017). Similarly, if the underlying obligation is a revolving credit facility, rather than a term loan, and the creditor's

obligation to make future advances is conditioned on the execution of a guaranty, then either the future advances themselves or the promise to make them would be consideration for the guaranty.

10. *See, e.g.*, In re Lamey, [2017 WL 3835797](#) at \*5 (Bankr. D.N.M. 2017); First Fin. Bank v. Johnson, [2017 WL 1929743](#) at \*2 (Ind. Ct. App. 2017); Northbrook Bank & Trust Co. v. O'Malley, [2017 WL 1268094](#) at \*8 (Ill. Ct. App. 2017); Badger v. Eighth Jud. Dist. Ct., [373 P.3d 89](#), 94 (Nev. 2016); Eginore v. Market Foods Ltd., LLC, [2006 WL 2692852](#) at \*3 (D. Kan. 2006); Helena Chemical Co. v. Caery, [220 S.W.3d 235](#), 237 (Ark. Ct. App. 2005); Chase Bank of Ohio v. Brookstone Ohio P'ship, [1990 WL 20104](#) at \*3 (Ohio Ct. App. 1990); Nogg Bros. Paper Co. v. Bickels, [446 N.W.2d 729](#), 732 (Neb. 1989); Green Shoe Mfg. Co. v. Farber, [712 P.2d 1014](#), 1017 (Colo. 1986); Sinclair Mktg., Inc. v. Siepert, [695 P.2d 385](#), 387 (Idaho 1985); McKnight v. Virginia Mirror Co., [463 S.W.2d 428](#), 430 (Tex. 1971).

Note, this principle might not apply to all guaranties. *See* West Branch State Bank v. Farmers Union Exch., [268 N.W. 155](#), 157 (Iowa 1932) (distinguishing an accommodation guaranty from a guaranty executed by a party in interest, and concluding that a guarantor of a corporate debt who was also a stockholder of the corporation was not a favorite of the law).

11. *See* Broadbent v. Fifth Third Bank, [59 N.E.3d 305](#) (Ind. Ct. App. 2016); RBS Citizens Bank v. Purther, [22 F. Supp. 3d 747](#) (E.D. Mich. 2014); Haggard v. Bank of Ozarks Inc., [668 F.3d 196](#) (5th Cir. 2012).

12. *See* HSBC Realty Credit Corp. (USA) v. O'Neill, [745 F.3d 564](#) (1st Cir. 2014).

13. *See* Gensco, Inc. v. Johnson, [2017 WL 3589251](#) (Wash. Ct. App. 2017) (the individual who signed a continuing guaranty of the obligations of a corporation and later rescinded the guaranty remained liable for the obligations incurred prior to rescission; the creditor's allocation of a portion of payments received after rescission to the newly incurred debts was effective because the credit agreement expressly stated that the creditor "may apply payments at its own discretion," unless contrary instructions were provided by the debtor).

14. Larasco, Inc. v. Del Norte, LLC, [2015 WL 2329040](#) (Wash. Ct. App. 2015).

15. G & W Warren's, Inc. v. Dabney, [218 Cal. Rptr. 3d 75](#) (Cal. Ct. App. 2017).

16. In re Gentry, [2014 WL 4723879](#) (D. Colo. 2014).

17. *See* [RESTATEMENT \(THIRD\) OF SURETYSHIP AND GUARANTY §§ 37-44](#). *See also* [Cal. Civ. Code §§ 2819-2825](#).

18. *See* [RESTATEMENT \(THIRD\) OF SURETYSHIP AND GUARANTY § 48\(1\)](#) & cmt. d; [Cal. Civ. Code § 2856\(b\)](#); Pacifica L 39 LLC v. Ramy, [2015 WL 394239](#) (Cal. Ct. App. 2015); JPMorgan Chase Bank v. East-West Logistics, LLC, [9 N.E.3d 104](#) (Ill. Ct. App. 2014); Wells Fargo Bank v. Osprey Commerce Ctr., LLC, [2014 WL 1271460](#) (M.D. Fla. 2014); Moayed v. Interstate 35/Chisam Road, L.P., [438 S.W.3d 1](#) (Tex. 2014); Coop. Centrale Raiffeisen-Boerenleenbank, B.A. v. Navarro, [978 N.Y.S.2d 186](#) (N.Y. App. Div. 2014). *See also* Texas Cap. Bank v. Dallas Roadster, Ltd., [2015 WL 1025207](#) (E.D. Tex. 2015) (a guarantor can release affirmative claims against the lender – whether known or unknown – and do so effectively using broad language that does not identify each cause of action).

19. For this reason, many transactional lawyers include a general waiver of suretyship defenses followed by a list of defenses that are expressly included in the scope of the general waiver.

20. *See* Stephen L. Sepinuck, *Waiving Suretyship Defenses*, [5 THE TRANSACTIONAL LAWYER 2](#) (Apr. 2015).

21. *See id.* (discussing Sumitomo Bank v. Iwasaki, [447 P.2d 956](#) (Cal. 1968) and [RESTATEMENT \(THIRD\) OF SURETYSHIP AND GUARANTY § 47](#)).

22. *See, e.g.*, In re Greektown Holdings, LLC., [2013 WL 3456976](#) (E.D. Mich. 2013).

23. *See, e.g.*, In re Lehman Bros. Holdings, Inc., [541 B.R. 551](#) (S.D.N.Y. 2015).

24. *See, e.g.*, Torin Associates, Inc. v. Perez, [2016 WL 6662271](#) (S.D.N.Y. 2016).

25. *See, e.g.*, 136 Field Point Holding Co. LLC v. Invar Int'l Holding, Inc., [2015 WL 1254846](#) (S.D.N.Y. 2015).

26. *See, e.g.*, JMT Capital Holdings, LLC v. Johnson, [2015 WL 3832674](#) (N.D. Cal. 2015) (based on Texas law, which regards a usury defense as personal to the debtor).

27. *See, e.g.*, Heartland Bank and Trust Co. v. Goers, [2012 WL 7005595](#) (Ill. Ct. App. 2012) (by waiving all defenses of the borrower, guarantors effectively waived any defense that the borrower could have asserted on the note based on the allegation that the lender caused the borrower to default; although a general waiver of defenses in a guaranty agreement does not waive defenses based upon a lender's breach of its duty to act in good faith, the lender did not act in bad faith).

28. *See, e.g.*, U.S. Bank v. Rosenberg, [2013 WL 272061](#) (E.D. Pa. 2013); Morris v. Comerica Bank, [2004 WL 1801034](#) (Mich. Ct. App. 2004).

29. *See, e.g.*, *J. Remora Maintenance LLC v. Efromovich*, [943 N.Y.S.2d 792](#) (N.Y. Sup. Ct. 2012).

30. *See id.*

31. *See, e.g.*, *Duval v. Albano*, [2017 WL 3053157](#) at \*13 (S.D.N.Y. 2017).

32. *See, e.g., id. But see U.S. Bank v. Rosenberg*, [2013 WL 272061](#) at \*5 & n.36 (E.D. Pa. 2013) (ruling that language in a guaranty waiving defenses warranted dismissal of an affirmative defense based on lack of consideration).

33. *See, e.g.*, *U.S. Bank v. Rosenberg*, [2013 WL 272061](#).

34. *See* U.C.C. § 9-602(7) & cmt. 4. At least one state has enacted a non-uniform version of § 9-602 that allows a guarantor or other secondary obligor to waive these rights. *See* [Wash. Rev. Code § 62A.9A-602](#).

35. *See* [RESTATEMENT \(THIRD\) OF SURETYSHIP AND GUARANTY §§ 22, 27](#). The distinction between reimbursement and subrogation can be important, for example, if the principal obligor granted the creditor a lien on property to secure the debt. In such a case, a guarantor would prefer to be subrogated to the creditor's rights, and thereby have the benefit of the lien on the collateral, rather than pursue its own reimbursement right.

36. *See* [11 U.S.C. § 547\(b\)](#).

37. *See* [11 U.S.C. § 101\(31\)\(B\)](#).

38. [874 F.2d 1186](#) (7th Cir. 1989).

39. *See* [Pub. L. No. 103-394](#), § 202, 108 Stat. 4106, 4121 (1994).

40. *See* [Pub. L. No. 109-8](#), § 1213(a)(2), 119 Stat. 23, 194-95 (2005).

41. *See* 11 U.S.C. § 101(10).

42. *E.g.*, *In re Adamson Apparel, Inc.*, [785 F.3d 1285](#) (9th Cir. 2015). *But see* *In re USA Detergents, Inc.*, [418 B.R. 533](#) (Bankr. D. Del. 2009) (ruling that such a waiver is ineffective).

43. *See* Stephen L. Sepinuck, *Revival Clauses in Guarantees: Protecting the Creditor from Preference and Fraudulent Transfer Risk*, [2 THE TRANSACTIONAL LAWYER 1](#) (June 2012).

44. *See* Stephen L. Sepinuck, *Very Interesting . . . or Is It: Limitations on Default Interest*, [3 THE TRANSACTIONAL LAWYER 2](#) (Feb. 2013).

45. *See* Stephen L. Sepinuck, *Binding Guarantors to Terms in the Note*, [1 THE TRANSACTIONAL LAWYER 1](#) (June 2011); Chelsey Thorne, *An Update on Binding Guarantors to a Forum-Selection Clause*, [4 THE TRANSACTIONAL LAWYER 4](#) (Feb. 2014).

46. *See also* *Morris v. Comerica Bank*, [2004 WL 1801034](#) at \*6 (ruling that a guarantor was liable for post-judgment interest at the statutory judgment rate because the guaranty did not specify otherwise, even though the underlying transaction documents did).



## Recent Cases

### SECURED TRANSACTIONS

*GEOMC Co. v. Calmare Therapeutics, Inc.*, [2017 WL 3585337](#) (D. Conn. 2012)

A corporation's CEO had both actual and apparent authority to enter into a security agreement on behalf of the corporation, and thus the security agreement was not *ultra vires*. Although two years later the corporation's board of directors declared that the CEO might have acted contrary to the best interests of the corporation and that the security agreement was retroactively "rendered unauthorized, rejected, and void," that declaration did not affect the validity of the security agreement.

*SEC v. ISC, Inc.*, [2017 WL 3736796](#) (W.D. Wis. 2017)

A secured party's financing statement, which erroneously had a space between the "Inc" and the period that follows it, was insufficient to perfect because a search against the debtor's correct name using the filing office's standard search logic did not reveal the filing.

*Cyber Solutions Int'l, LLC v. Priva Security Corp.*, [2017 WL 3599578](#) (W.D. Mich. 2017)

A secured party with a perfected security interest in the debtor's inventory of computer chips, manufactured pursuant to a licensing agreement, had priority over the buyer/licensor that had allegedly prepaid for the chips. Nothing in the agreements between the debtor and the buyer indicated that the buyer owned the chips.

*Ascentium Capital LLC v. Adams Tank & Lift Inc.*, [2017 WL 4102741](#) (M.D. Ga. 2017)

A lender expecting to obtain a PMSI in equipment and which advanced funds directly to the debtor's seller had a cause of action against the seller for money had and received – but not for unjust enrichment – for not returning the portion of the funds allocated to equipment that the debtor never purchased, and instead forwarding those funds to the debtor.

*GemCap Lending, LLC v. Quarles & Brady, LLP*,  
[2017 WL 4081884](#) (C.D. Cal. 2017)

A secured party did not have a cause of action against the debtor's counsel for professional malpractice in connection with an opinion letter counsel issued because, even though the opinion stated that the Loan Agreement creates a valid security interest in favor of the secured party in the debtor's rights in the "collateral," and some of the intended collateral was in fact owned by a related entity, the opinion letter defined "collateral" to be the debtor's property and thus was not incorrect.

## BANKRUPTCY

*In re East Coast Foods, Inc.*,  
[2017 WL 3701211](#) (Bankr. C.D. Cal. 2017)

The recipient of an avoidable fraudulent transfer has no claim for the consideration provided if the recipient did not act in good faith.

## LENDING & CONTRACTING

*Gensco, Inc. v. Johnson*,  
[2017 WL 3589251](#) (Wash. Ct. App. 2017)

The individual who signed a continuing guaranty of the obligations of a corporation and later rescinded the guaranty remained liable for the obligations incurred prior to rescission. The guaranty was not limited either to debts incurred at only one of the debtor's locations or to the amount of the desired credit limit in the initial application because the guaranty covered "all existing and future indebtedness." The creditor's allocation of a portion of payments received after rescission to the newly incurred debts was effective because the credit agreement expressly stated that the creditor "may apply payments at its own discretion," unless contrary instructions were provided by the debtor.

*Citimortgage, Inc. v. Equity Bank*,  
[2017 WL 3588257](#) (E.D. Mo. 2017)

Because the seller of mortgage loans had breached representations and warranties regarding some loans, the seller was contractually obligated to repurchase the loans that still existed. It did not matter that the loan buyer failed to include the repurchase amount in the repurchase request. However, the seller was not obligated to repurchase the loans which, prior to the repurchase request, had been liquidated through foreclosure, and thus no longer existed.

*Pine River Master Fund Ltd. v. Amur Finance Co.*,  
[2017 WL 4023099](#) (Del. Ch. Ct. 2017)

A debtor that borrowed \$150 million to invest in operating companies breached its Credit Agreement with the lender by using loaned funds to pay \$7 million for legal fees incurred by related entities because the Credit Agreement authorized the use of funds to pay the administrative agent's legal fees, not the legal fees of entities related to the borrower. However, the payment did not constitute an Event of Default as a failure to pay interest when due, because even if such amounts should have been treated as PIK Accrual under the Credit Agreement waterfall, such amounts are capitalized into principal, due at maturity, not treated as interest.

*Cece & Co. Ltd. v. U.S. Bank*,  
[2017 WL 3253370](#) (N.Y. Sup. Ct. 2017)

*NMC Residual Ownership LLC v. U.S. Bank*,  
[2017 WL 3253445](#) (N.Y. Sup. Ct. 2017)

The holders of residual interests in a REMIC trust stated a claim for breach of contract against the trustee for selling trust assets to itself at a price below market. Although an indenture trustee does not owe a fiduciary duty to the trust beneficiaries and its obligations are defined by the terms of the indenture agreement, it does owe a duty to avoid conflicts of interest. There would be no claim if the indenture agreement expressly gave the trustee the right to purchase trust assets at a price below market, but it does not; it merely states that the trustee may terminate the trust by purchasing the remaining trust assets. The agreement obligates the trustee to deposit a specified amount in an account for the beneficiaries, but does not state that this amount is the purchase price.

*State Bank & Trust Co. v. Philly Wholesale, LLC*,  
[2017 WL 3279023](#) (E.D. Pa. 2017)

A liquidated damages clause in an equipment lease that provided for payment of both the entire unpaid amount under the lease and the present value of all future rent reduced by three percent was an unenforceable penalty. The sum was essentially a double recovery and was not a reasonable estimate of the lessor's damages, which might be the future income stream under the lease (*i.e.*, rent) plus the diminished value of the property upon repossession and the cost in time, effort, and expense in dealing with default. Moreover, while a late fee can be charged on past due amounts, the lessor could not get both a late fee and default interest with respect to the same missed payment because that would be a double recovery for the same injury. Because the court awarded default interest, there would be no award of the claimed late fees.



*Bautista Cayman Asset Co. v. Desarrollos Bucana, S.E.*,  
[2017 WL 3610497](#) (D.P.R. 2017)

Language in three promissory notes, which were incorporated by reference into a loan agreement, by which the borrowers “submit ourselves expressly to the competency of the state courts of the City of San Juan, Puerto Rico,” was a mandatory forum selection clause that bound both parties to litigate in the named courts.

*Coastal Investment Partners, LLC v. DSG Global, Inc.*,  
[2017 WL 3605502](#) (S.D.N.Y. 2017)

A corporation that provided a \$72,500 promissory note with 8% interest in return for a \$10,000 loan, which provided that \$62,500 of the debt could be “redeemed” for \$1 and which gave the holder a right to convert the note to equity, raised a plausible defense that the note was criminally usurious.

*Georgia Commercial Stores, Inc. v. Forsman*,  
[2017 WL 3430241](#) (Ga. Ct. App. 2017)

An unsecured creditor of an insolvent LLC stated claims for breach of fiduciary duty and intentionally fraudulent transfer against the LLC’s president for causing the LLC to repay a \$239,000 debt to the president. Just as the officer and directors of an insolvent corporation owe a fiduciary duty to the corporation’s creditors, so too do the managing members of an insolvent LLC. Although the LLC’s assets were fully encumbered and the payment was made with the secured creditor’s approval, those facts alone did not demonstrate that the unsecured creditor was uninjured by the transfer; the claim of a creditor that diligently pursues collection are not reduced or defeated by the hypothetical claims of other creditors who have slept on their rights.

*Crystal Bay Lending Partners, LLC v. JMA Boulder Bay Holdings, LLC*, [2017 WL 3222271](#) (Nev. 2017)

The entity that bought a senior lender’s “right, title and interest in, to and under the Loan Documents” could enforce the intercreditor agreement that the senior lender had entered into when the loan was made. Even though the intercreditor agreement was not expressly listed as one of the Loan Documents, that term was defined with broad language that necessarily included the intercreditor agreement.

*United Leasing, Inc. v. Balboa Capital Corp.*,  
[2017 WL 3674926](#) (S.D. Ind. 2017)

Because the phrase “to Seller’s knowledge:” preceded a list of representations and warranties in an agreement for the sale of leases, it modified all of them, even though it arguably made no sense with respect to some of them. Because the buyer’s complaint did not allege that the seller knew of the defects in some lease documents, the complaint had to be dismissed.

*3432 West Henderson Building, LLC v. Gizynski*,  
[2017 WL 2672552](#) (Ill. Ct. App. 2017)

A mortgagee was entitled to default interest on amounts paid for attorney’s fees incurred in connection with the mortgage because the mortgage expressly provided that such expenses “shall become a part of the Indebtedness payable on demand and shall bear interest at the Note rate from the date of the expenditure until repaid.”



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