

# Bullet Proof Guaranties

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## Guaranties: Who, What, Why, When, & Where

- What?
  - Agreement to pay another's debt.
  - Strictly construed.
- Who?
  - "Primary Obligor"/"Principal" = Customer/Corporate Debtor
- Why?
  - Large customer (with leverage) v. smaller privately owned customer
  - Insolvency & Fraudulent Transfers
- When?
  - Outset of Relationship
- Where?
  - Credit Application
  - Conspicuous

## Key Formal Requirements

- Statute of Frauds
- Signature Requirements
  - Individual signature block
  - *Mencher v. Weiss*, 306 N.Y. 1, 7, 114 N.E.2d 177 (1953).
  - Handwritten signatures preferable, especially for secured creditors
  - UETA: Only applies to unsecured credit transactions.
  - Adopted by all states except NY, WA, and IL
  - e.g., [www.docusign.com](http://www.docusign.com)
- Strict Construction
  - “As a general rule, guarantee agreements are strictly construed against the party ‘at whose insistence such language was included.’”
  - *Herz v. 141 Bloomfield Ave. Corp.*, A-2954-13T2, 2015 WL 2465027, at \*2 (N.J. Super. App. Div. June 1, 2015)

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## Key Formal Requirements (cont.)

- Consideration
  - **Defined:** “Consideration may take many forms and may be based upon either ‘a detriment incurred by the [creditor] or a benefit received by the [customer].” *Seaview Orthopaedics ex rel. Fleming v. Natl. Healthcare Resources, Inc.*, 841 A.2d 917, 921 (N.J. Super. App. Div. 2004).
  - **Timing:** “Because the guaranty and the loan were not executed at the same time as part of the same agreement, the guaranty ‘must be supported by separate consideration moving to the guarantor...’” *Great Falls Bank v. Pardo*, 622 A.2d 1353, 1359 (N.J. Super. Ch. Div. 1993), *aff’d*, 642 A.2d 1037 (N.J. Super. App. Div. 1994).
  - **Example:** A promise to forbear to sue a third person may be a good consideration for defendant’s promise to pay the third person’s debt to plaintiff, even though no definite term of forbearance is set; for the law would hold the creditor to forbear for a reasonable time. *Meyers v. Hockenbury*, 34 N.J.L. 346, 347 (N.J. Sup. Ct. 1870).

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## Duration, Revocation, & Assignability

- Continuing guaranties
  - Cover future extensions of credit.
- Revocation
  - “A continuing guaranty may be revoked at any time by the guarantor, in respect to future transactions, unless there is a continuing consideration as to such transactions which he does not renounce.”  
*Cal. Civ. Code* § 2815
  - Irrevocable by express terms.
  - Revocable with written notice, except as to then-existing indebtedness.
- Assignability
  - Changes in ownership of creditor or customer.

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## Suretyship & Personal Defenses

- Suretyship Defenses Defined
  - “The basic rule on the liability of sureties is that ‘the surety is not liable to the creditor unless his principal is liable’[;] thus he may plead the defenses which are available to his principal[.]” *Rhode Island Hosp. Trust Nat. Bank v. Ohio Cas. Ins. Co.*, 789 F.2d 74, 78 (1st Cir. 1986).
- Rationale
  - “[T]he purpose of a suretyship in commercial transactions is to protect the creditor against the possible unjustified nonpayment by the principal debtor. Once a court has held that the debtor has no debt resulting from a given transaction, *when the reason for the extinction of the claim stems from behavior of the creditor*, it would be unjust then to allow the creditor to collect from the debtor's surety.” *Rhode Island Hosp. Trust Nat. Bank v. Ohio Cas. Ins. Co.*, 789 F.2d 74, 80 (1st Cir. 1986) (emphasis in original).

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## Suretyship & Personal Defenses (cont.)

- Examples of Suretyship & Personal Defenses
  - Notice (of default, future advances, etc.)
  - Modification of primary obligation (*e.g.*, suspension of rights) without consent of guarantor
  - Accord & Satisfaction
  - Bankruptcy
  - Invalidity or unenforceability of primary obligation (*e.g.*, forgery, immunity, etc.)
  - Statute of Limitations
  - Judgment in favor of primary obligor
  - Performance by principal

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## Suretyship & Personal Defenses (cont.)

- Examples of Suretyship & Personal Defenses (cont.)
  - Collection v. Payment

“A guaranty to the effect that an obligation is good, or is collectible, imports that the debtor is solvent, and that the demand is collectible by the usual legal proceedings, if taken with reasonable diligence.” *Cal. Civ. Code* § 2800

- Compelling creditor to sue principal/co-guarantor
- Release of co-guarantor
- Application of collateral of primary obligor (*e.g.*, Letter of Credit)
- Impairment of collateral/subrogation rights of guarantors

*Sterling Factors Corp. v. Freeman*, 271 N.Y.S.2d 343 (N.Y. Sup. Ct. 1966), *aff'd*, 279 N.Y.S.2d 577 (N.Y. App. Div. 2d Dept. 1967)

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## Suretyship & Personal Defenses (cont.)

- Waiver of Defenses
  - “[T]he guarantors unconditionally guaranteed payment of all monies due from [the primary obligor][.] There also is no dispute as to the fact that the guarantors waived the right to assert any legal or equitable defenses to enforcement of their obligations.” Gen. Elec. Capital Corp. v. Imaging Ctr. of Oradell, LLC, 2013 WL 2494195, at \*5 (N.J. Super. App. Div. June 12, 2013).
  - N.J. U.C.C. Art. 3. Official Comment No. 2. “The importance of suretyship defenses is greatly diminished by the fact that they can be waived.” N.J. Stat. Ann. § 12A:3-605.
  - “[I]n the Unconditional Suretyship Agreement, [the guarantor] explicitly waived all notices and defenses.” Citizens Banking Co. v. McKittrick, 1991 WL 79153, at \*2 (S.D.N.Y. May 6, 1991).
  - “Sections 2845 and 2849 have often been found to have been waived by language contained in documents.” Pearl v. Gen. Motors Acceptance Corp., 16 Cal. Rptr. 2d 805, 808 (Cal. App. 4th Dist. 1993)

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## Suretyship & Personal Defenses (cont.)

- Waiver of Defenses (cont.)
  - Impairment of collateral

“A waiver in a guaranty limiting a creditor's responsibility as to collateral is enforceable[.] Where, however, a demand is made of the creditor to liquidate the collateral and subsequent to the refusal to liquidate the collateral substantially declines in value, the failure to liquidate, if negligent, is a breach of the secured party's duty to use reasonable care in the custody and preservation of collateral. A secured party's duty to act with due diligence, reasonableness and care may not be disclaimed by agreement.” Fed. Deposit Ins. Corp. v. Frank L. Marino Corp., 425 N.Y.S.2d 34, 36 (N.Y. App. Div. 2d Dept. 1980).

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## Types of Guaranties

- Personal v. Corporate Guaranties
  - Problem of divestiture of assets
  - Request list of guarantor's assets/financial statement (11 U.S.C. s. 523)
- Spousal Guaranties
  - Consideration issues

*Perry v. Cassidy*, 170 Cal. App. 2d 175, 175-177 (Cal. App. 3d Dist. 1959)

- The Equal Credit Opportunity Act

“A number of Courts have held that, where the property of a Guarantor is jointly owned by his or her spouse, requiring the spouse to co-sign the Guaranty does not violate the ECOA. \*\*\* Further, in order to establish a...case for violating the ECOA, the...Defendants would need to demonstrate that the...husbands individually qualified for the loans, absent the jointly-owned property.” *LOL Fin. Co. v. F.J. Faison, Jr. Revocable Trust*, 2010 WL 3118630, at \*9–10 (D. Minn. July 13, 2010)

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## Guarantee Provisions that Maximize Leverage and Reduce Costs

- Agreement to vendor's specified interest finance charges
- Liability for costs of collection (attorneys' fees, etc.)
- Forum Selection Clause
- Waiver of defenses

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## Impact of Bankruptcy of Primary Obligor

- Applicability of automatic stay to non-debtor guarantors
- Injunction to stay action against guarantors
- Release of non-debtor guarantor under plan of reorganization
- Preferential transfers & revival of guarantor's liability

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## Conclusion

- Sample short-form Guaranty

[Guarantor] hereby irrevocably and unconditionally guaranties the full and complete payment and performance of all of [Customer's] obligations under the Credit Application, as and when due. It shall not be necessary for [the creditor] to exhaust any remedies against [Customer] prior to asserting its remedies against [Guarantor] under this Guaranty. This Guaranty is a continuing guaranty of performance and payment, and not of collection only. [Guarantor] waives all defenses with respect to this Guaranty including but not limited to any and all suretyship defenses, defenses based upon impairment of collateral, and any other statutory, legal, or equitable defenses. *RCJV Holdings, Inc. v. Collado Ryerson, S.A. de C.V.*, 18 F. Supp. 3d 534, 540 (S.D.N.Y. 2014)

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