MANUAL ON GUARANTIES AND SURETIES

NOVEMBER 18, 2009

THE MATERIAL USED IN THIS MANUAL IS FOR TEACHING OF THE PHILADELPHIA CLE SEMINAR.

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# MANUAL ON GUARANTIES AND SURETIES

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1. CHARACTERISTICS

1.1. The Guaranty Family. Guaranties, warranties, sureties, indemnities, hold harmless are variants of the promise by one guarantor to be responsible for the obligations of someone else. Though some authorities characterize the guaranty agreement as a potential future liability and not currently enforceable until the Borrower fails to perform, the provision that provides the guaranty itself is usually surrounded by a number of representations, warranties, and other covenants which are then currently enforceable. The general rule of law is that a guaranty is a separate independent contract, and the guarantor has secondary liability after the default of the debtor is proven. As a guaranty is simply a form of contract, it requires no special language and can be created by writing; but some authorities say it is subject to the statute of frauds as to guaranties that would otherwise be oral and implied by course of conduct.

1.2. Surety. A surety has two distinguishing features when compared to a guaranty. First, it implicates primary and joint liability with the borrower. Second, whereas a guarantor typically answers a reasonable effort for collection to compel the principal to perform first, and then notice of the failure; but the surety does not. Third, a surety can be joined as a co-responsible party, but a guarantor is liable under a separate contractual relationship. Fourth, a guarantor can be revoked until the offer to act as accepted, but a surety is initially and immediately irrevocable unless the right to revoke is reserved.

"This Agreement 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

2 Though once considered the same, a warranty is distinguished by being a primary obligation, and liability is based on whether the assertion made is as represented. A representation, on the other hand, is not actionable if the aggrieved party knows or should have known it was false. "The technical difference between representations and warranties - representations are statement of past or existing facts and warranties are promises that existing or future facts are or will be true - has proven unimportant in acquisition practice. See Freund, Anatomy of a Merger 153 (1975). Separating them explicitly in an acquisition agreement is a drafting nuisance, and the legal import of the separation has been all but eliminated." ABA Model Stock Purchase Agreement Commentary at 46. "Under Ziff-Davis’s theory [which the court rejects], the reliance which is a necessary element for a claim of breach of express warranty is essentially that required for a tort action based on fraud or misrepresentation - i.e., a belief in the truth of the representations made in the express warranty and a change of position in reliance on that belief."**This view of "reliance" - i.e., as requiring no more than reliance on the express warranty as being a part of the bargain between the parties - reflects the prevailing perception of an action for breach of express warranty as one that is no longer grounded in tort, but essentially in contract. The express warranty is as much a part of the contract as any other term. Once the express warranty is shown to have been relied on as part of the contract, the right to be indemnified in damages for its breach does not depend on proof that the buyer thereafter believed that the assurances of fact made in the warranty would be fulfilled. The right to indemnification depends only on establishing that the warranty was breached." (citations omitted) CBS, Inc. v Ziff Davis Publishing Co., 75 N.Y. 2d 496, 502-504 (Ct of App 1990). See Model Asset Purchase Agreement at pages 214-217

3 The vise of logic requires that if a person is directly liable as a borrower, it cannot also be secondarily liable as a guarantor.
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.”

1.3. Indemnity. An indemnity is considered a primary liability but the loss covered
must be suffered, rather than anticipated. A promise to compensate or make whole the
guaranteed party after damages are assessed or a loss is sustained, a reactive stance. Like other
guaranties, indemnities can be broad or limited. Although parties frequently attempt to waive
them, typical defenses to indemnity obligations include the negligence or willful misconduct of
the indemnified party. Indemnification as used in the corporate context is a misnomer to a real
estate specialist because it connotes protection from liability to third parties after damages have
been determined, whereas corporate lawyers have adopted a broader meaning for that term,
covering liability between the contract parties as well. Indemnification in the corporate
transactional agreement is really a stand-in for the default remedy of damages. The buyer is
entitled to indemnification for loss from seller’s breach of representations or covenants, any pre-
existing conditions, broker commission, or Seller’s retained liabilities, among other things.

1.4. Hold Harmless. A hold harmless agreement is frequently considered preemptive,
requiring the guarantor to prevent loss, rather than make whole after a loss. A promise to keep
the guaranteed party free from cost, damage or liability, a proactive stance. Like indemnity
agreements, discussed above, hold harmless agreements can be used to address performance
obligations that may not directly relate to the loan or the financial terms thereof (such as debt
service obligations), for example, they can protect a lender from potential costs, or the
diminution of the value of its collateral, by forcing the borrower (and/or the creditworthy
guarantor) to be responsible for and perform obligations affecting the real property, such as
environmental issues, damage claims, and property loss.

4 This confirms that Agreement is a guaranty of payment not 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.” 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
collection, creditor’s negligence, or lack of due diligence, could not lost or dissipated the collateral could not be a
817 (N.D. Ill. 1988), where the District Court observed that although “impairment of security resulting from a
creditor’s unreasonable conduct, negligence or bad faith normally discharges a surety from liability to the extent of
the impairment, the defense of impairment of collateral is not available to one who has given an unconditional
guarantee of payment.”

5 “The common law definition of the term ‘indemnification’ describes a restitutionary cause of action in which a
plaintiff sues a defendant for reimbursement of payments made by the plaintiff to a third party. A court may hold,
therefore, that a drafter’s unadorned use of the term ‘indemnification’ (usually coupled with “and hold harmless”)
refers only to compensation for losses due to third-party claims…. Modern usage and practice have redefined the
term “indemnification” in the acquisition context to refer to compensation for all losses and expenses, from any
source, caused by a breach of the acquisition agreement (or other specified events). The courts, presumably, will
respect express contract language that incorporates the broader meaning.” (cites omitted). ABA Model Asset
Purchase Agreement at 221.
1.5. **Guaranty of Defense.** A guaranty to provide legal representation and expenses to defend the guarantied party from costs of claims.

1.6. **General or Special.** A general guaranty can be exercised by any holder. It need not name obligees. A special guaranty is for the benefit of specifically identified obligees. The real estate guaranties are almost always special guaranties.

1.7. **Absolute or Conditional.** Though guaranties require the default by the borrower as a pre-condition to liability, absolute guaranties require no other action, and conditional guaranties require some other action.

"Guarantor’s obligations hereunder shall be absolute, unconditional and irrevocable, regardless of whether the proceeds of the Loan are disbursed prior or subsequent to the filing of a Federal or state bankruptcy petition with respect to Borrower. Guarantor’s obligations under this Agreement shall include, but not be limited to, any interest, late charges, attorneys’ fees, or other sums coming due under the terms of the Loan Documents (without reference to the effect of Bankruptcy laws) subsequent to the filing of a Federal or state bankruptcy petition with respect to Borrower regardless of whether applicable Bankruptcy laws permit such sums to be collected from Borrower or to accrue with respect to Borrower."

1.8. **Payment or Collection.** One significant difference is in guaranties of payment or collection. The former is considered absolute; if the borrower does not pay when due, then the guarantor shall. The latter is considered actionable only if the borrower does not pay and the creditor cannot collect after exercising due diligence.

1.9. **Parties.** Guarantors can be individuals or entities. If the Guarantor is an individual, Guarantor’s spouse cannot sign this Agreement solely because of the spouse’s marital relationship with the Guarantor, or the spouse’s guaranty would be 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.\(^6\)

1.10. **Joint and Several.** The distinctions are antique and anachronistic, but still create different results in some jurisdictions, including Pennsylvania. Generally, if the parties are jointly liable, then they are liable together for the obligation, whereas if they are severally liable, then each of them is liable separately for the obligation. Joint liability imposes the following three rules:

1. Compulsory joinder of joint promissors;
2. Judgment for or against all joint promissors;

(3) Discharge for all joint promissors as a result of the discharge of any joint promissory.

The courts have held that in the absence of a stated intent, the parties are deemed to be jointly rather than severally liable. If one of the jointly liable parties is in bankruptcy or otherwise unable to be joined, an action which would otherwise be required to name all partners may be subject to being stopped.

"If Guarantor consists of more than one person, firm, or corporation, the obligations and liabilities under this Agreement of those persons, firms and corporations shall be joint and several, and the word “Guarantor” shall mean all or some or any of them. For purposes of this instrument the singular shall be deemed to include the plural, and the neuter shall be deemed to include the masculine and feminine, as the context may require."

1.11. Obligation in US Dollars.

1.11.1. Formation. Pennsylvania requires of liens only that they state the amount of the original indebtedness. There is no specific requirement for a dollar amount.

1.11.2. Recording. The Records Office of each county in which each mortgaged property is situated has to be consulted on the issue of recording euro-denominated mortgages. State law does not suggest any impediment to such recording, but neither does any state authority require the counties to accept euro-denominated mortgages.

1.11.3. Satisfaction. The statutory form of mortgage satisfaction pieces, 21 P.S. § 721-5, does not preface the amount blank with a dollar sign. However, the same Mortgage Satisfaction Act does require a plaintiff-debtor suing for mortgage satisfaction to express in dollars the debt such plaintiff claims to have satisfied.

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7 See *Keystone Bank v. Flooring Specialists, Inc.*, 518 A.2d 1179 (Pa. 1987) where the Pennsylvania Supreme Court answered this in the affirmative. See also *In re: Robert Bahara and Elaine Bahara*, 219 B.R. 77,1998 U.S. Dist. LEXIS 3067, 35 UCC Rep. Serv. 2d (Callaghan) 1253 (1998): "It must be emphasized that subsection [§3-606] (a)(l) relates to the release of an individual from liability that effectively destroys a co-surety’s right of recourse against the released party. An express reservation of rights against the non-discharged parties is presumed to preserve rights of recourse. This explains why a non-discharged co-surety obtains a discharge of his obligation for any amount due in excess of his proportionate share of the debt, but not for his proportionate share of the debt." In commenting on whether the debtors were entitled to the impairment of collateral defense under UCC section 3-606(a)(2) of the UCC under their guaranty, the Bankruptcy Court stated, "[t]his defense applies where the co-surety is obligated to pay more than his proportionate share of the underlying debt and the creditor has taken some action with respect to collateral otherwise available to the co-surety to enforce the contribution rights against other co-sureties. Under UCC §3606, the co-surety bears the burden of demonstrating that the creditor’s alleged impairment of the collateral has resulted in the co-surety being liable for more than its pro-rata share, i.e., the creditor’s action in regard to collateral has impaired a co-surety’s ability to recover full contribution for any amount in excess of the co-surety’s proportionate share of the debt." Id. at 84.

8 See, e.g., 1 P.L.E. COMMERCIAL TRANSACTIONS § 51 (2003)("No particular form of words is necessary in order to constitute a mortgage; it is sufficient if it be in writing, signed by the owner of the particular property or interest mortgaged, and specify the debt for which it is security.")
1.11.4. **Procedural Forum.** Each of the administrative provisions referenced above require that the parties use "substantially... the following form." There is no case law indicating whether a foreign currency expression of debt constitutes a legally substantial deviation from the statutory form. However, would be grossly against the equities for the Pennsylvania court system to deny satisfaction where a debt has been paid in full and according to its terms.

1.11.5. **Foreclosure.** Pennsylvania's form of civil action requires a statement of the amount in controversy, in part to determine whether, under county rules, the claim must undergo compulsory arbitration. Pa. R.C.P. Rule 1021 (2003). That determination requires a dollar expression of the amount demanded. In a foreclosure action, the Praecipe for Writ and Writ of Execution are both set up to express all amounts in dollars. Pa. R.C.P. Rule 3256 and 3257, respectively. Again, plaintiff must use "substantially... the following form."

1.11.6. **County administrative issues.** In addition, the National Mortgage Law Summary (2003)(hereinafter, "Bluebook") cautions that counties may impose poundage (typically based on a percentage of the value of the foreclosed-upon property) and may set a dollar-denominated minimum bid (based partially on the poundage and the value of tax liens, if any). Bluebook 257. Additional research will have to be done to see whether each county, in its wide zone of discretion under Pennsylvania law, has implemented further institutional barriers to a euro-denominated foreclosure sale.

1.11.7. **Analysis: Legal Impediments to a Euro-Denominated Award.** In addition to these administrative hurdles, it remains an open question whether a Pennsylvania court can issue a euro-denominated judgment. The established rule in the United Kingdom and the United States had been that courts could not enforce, and therefore could not enter, a judgment in any currency other than that issued by their sovereign.9 The Pennsylvania state case most on-point, Pennsylvania R.R. Co. v. Cameron, 80 Pa 458 (1924), expressed the traditional rule that, "Our courts cannot give judgment in sterling currency. It would be ineffective, as there would be no means to enforce it; therefore they must reduce the pounds, shillings, and pence mentioned in the bill of lading into American currency at the rate there fixed, which is the par nominal or normal rate of exchange." Cameron is currently cited by 10 Standard Pennsylvania Practice 2d § 65:10, *Judgments, generally*, for the proposition that: "When a verdict is rendered for a specific sum of money on an obligation stated in terms of a foreign currency, the foreign currency mentioned in the instrument must be reduced to its equivalent in terms of American currency." Cameron hasn't been cited by a court since 1950. Its decision may have rested, without explicit citation, on now-excised provisions of the federal Coinage Act of 1792.10 However, there is no case law contrary to Cameron in Pennsylvania, neither among state cases nor in the decisions of the federal Third Circuit. Like many states, Pennsylvania has not adopted the Uniform Foreign Money Claims Act, which would clarify the issue. The last time a federal court with jurisdiction over Pennsylvania considered the matter,11 "[t]he parties agree[d] that a United States court

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10 see Beal, supra, at 106-08

cannot render a judgment in foreign currency; its judgment must be expressed in United States Currency." That court gave considerable attention to the issue of which date's exchange rate to use. It concluded: "If a state rule is not applied, forum shopping will occur. A defendant facing a suit demanding payment would seek removal when the federal rule was less favorable to the creditor. It would be inequitable to allow diverse defendants to have this advantage where similarly situated non-diverse defendants would not. There is no strong countervailing federal interest in the application of federal law and no harm to any federal policy or interest. Therefore, the issue is substantive and state law applies."\textsuperscript{12} Finding "no decision of the Pennsylvania Supreme Court determining the date for conversion of foreign currency in a breach of contract action" and "no decision of the Superior Court on this issue either,"\textsuperscript{13} the court held: "In the absence of precedent, we believe the Pennsylvania Supreme Court would look to the Restatement of Foreign Relations Law of the United States (Tent. Draft No. 6 1985). Section 823 provides that the "conversion rate is to be made at such rate as to make the creditor whole and to avoid rewarding a debtor who has delayed in carrying out the obligation." (Provision adopted on May 14, 1986). This rule prevents fluctuating exchange rates from causing the injured or non-breaching party to bear the loss. Here, defendants have resisted paying a debt owed for more than two years so that they should bear the risk of a fluctuating exchange rate."\textsuperscript{14} However, "[e]ven if Pennsylvania would not adopt the Restatement view, such authority as there is makes it clear that the intention of the parties should control. See Willing's Estate, 292 Pa. 51, 140 A. 558 (1928)." In that case, the question of whether one of an estate's bequests would be transferred in gold or paper francs was resolved by looking at the intent of the decedent. By the court's logic, if a loan agreement interpreted under Pennsylvania law specified a payment-date conversion (the safest thing for the bondholders), then the court should enforce that provision.

1.11.8. Conclusion. The parties are free under Pennsylvania law to: (1) choose New York law and (2) set a conversion date, at least as close to the payment of the bondholders as the date of entry of judgment. It is not clearly established whether, either as a matter of New York law or as a private contractual matter, the parties could specify conversion as of the payment date (which would pose the least currency risk to bondholders). Also, there are a variety of administrative hurdles that a euro-denominated mortgage may confront, and not all of them can be determined in advance.

1.11.9. Proposed Strategies:

(a) The mortgage is to be paid in euros.

(b) However, the parties agree on a USD Initial Indebtedness Equivalent to the amount owed in euros. They also agree on a Running USD Equivalent of the principal due, which will be continually calculated based on interday rates.

\textsuperscript{12} Id. at 1228.
\textsuperscript{13} Id. at 1227.
\textsuperscript{14} Id.
(c) They further agree, for the convenience of the parties, that the USD Equivalents may be supplied by either party to any governmental entity which requires them for the forming, recording, taxing, or enforcing of the mortgage. However, every time such Equivalents are given, the other party shall be given notice, and they shall be given with a disclaimer that the Equivalents only reflect the dollar value of a debt denominated in euros.

(d) Lender shall have the option to convert its euro-denominated mortgage into a dollar-denominated mortgage and a hedge, executed by the borrower to the benefit of the lender. Both instruments shall be secured by the real estate. The value of the hedge will be the sum of US dollars needed to purchase the euros, if any, owing to bondholders after the conversion of dollar-denominated payments (including judgments) on the mortgage. Since both the new mortgage and the hedge will be expressed in dollars, there will be no issue of enforceability in US courts.

(e) Lender’s conversion option shall be triggered automatically in the event that lender calls a default.

1.12. Confession of Judgment. In Pennsylvania, this is incorporated by Lender’s counsel as a companion document to both the Note and the Agreement. This practice is the result of court decisions providing that a borrower could waive its due process rights to a deprivation of hearing and notice when it voluntarily, knowingly and intelligently consents to an agreement containing a cognovit clause. 15

“For Pennsylvania Guaranties: THE FOLLOWING PARAGRAPH SETS FORTH A WARRANT OF AUTHORITY FOR AN ATTORNEY TO CONFESS JUDGMENT AGAINST THE GUARANTOR. IN GRANTING THIS WARRANT OF ATTORNEY TO CONFESS JUDGMENT AGAINST THE GUARANTOR, THE GUARANTOR HEREBY KNOWINGLY, INTENTIONALLY, AND VOLUNTARILY, AND, ON THE ADVICE OF THE SEPARATE COUNSEL OF THE GUARANTOR, UNCONDITIONALLY WAIVES ANY AND ALL RIGHTS THE GUARANTOR HAS OR MAY HAVE TO PRIOR NOTICE AND AN OPPORTUNITY FOR HEARING UNDER THE RESPECTIVE CONSTITUTIONS AND LAWS OF

THE UNITED STATES AND THE COMMONWEALTH OF PENNSYLVANIA.

GUARANTOR HEREBY AUTHORIZES ANY ATTORNEY OF ANY COURT OF RECORD IN PENNSYLVANIA, OR ELSEWHERE, TO APPEAR FOR GUARANTOR IN ANY ACTION BROUGHT ON THIS AGREEMENT, AND TO CONFESSION JUDGMENT AGAINST GUARANTOR FOR ALL PRINCIPAL AND INTEREST AND ALL OTHER SUMS THEN DUE PURSUANT TO THE TERMS OF THE NOTE, MORTGAGE AND SUCH OTHER COLLATERAL DOCUMENTS, OR ANY OF THEM, AND FOR COSTS OF SUIT AND AN ATTORNEY’S COMMISSION OF FIVE PERCENT (5%), BUT IN ANY EVENT NOT LESS THAN TEN THOUSAND DOLLARS ($10,000.00), TOGETHER WITH INTEREST ON ANY JUDGMENT OBTAINED BY LENDER AT THE RATE OF INTEREST SPECIFIED IN THE NOTE AFTER DEFAULT, INCLUDING INTEREST AT THAT RATE FROM AND AFTER THE DATE OF ANY SHERIFF’S OR JUDICIAL SALE UNTIL ACTUAL PAYMENT IS MADE TO LENDER OF THE FULL AMOUNT DUE LENDER, AND FOR SO DOING THIS SHALL BE A GOOD AND SUFFICIENT WARRANT. GUARANTOR WAIVES AND RELINQUISHES ALL ERRORS, DEFECTS AND IMPERFECTIONS IN ANY ENTRY OF JUDGMENT AS AFORESAID, OR IN ANY PROCEEDING PURSUANT THERETO, AND ALL BENEFITS THAT MAY ACCRUE TO HIM BY VIRTUE OF ANY LAW OR RULE OF COURT RELATING TO A STAY OF EXECUTION OR EXEMPTING ANY PROPERTY FROM LEVY OR SALE UNDER EXECUTION. THE AUTHORITY HEREIN GRANTED TO CONFESSION JUDGMENT SHALL NOT BE EXHAUSTED BY ANY EXERCISE THEREOF BUT SHALL CONTINUE FROM TIME TO TIME AND AT ALL TIMES UNTIL ALL OBLIGATIONS OF BORROWER TO LENDER HAVE BEEN FULLY DISCHARGED."
2. **DEFENSES**

2.1. **Change in Status of Obligee.** An old rule which is still recognizable stands for the proposition that a change in the composition of a partnership defeats its ability to enforce a guaranty to an earlier iteration.\(^\text{16}\)

2.2. **Assignment.** Another ancient rule is that an assignment of a special guaranty without the guarantor’s consent may not be enforceable, unless there is not material alteration of the guarantor’s obligations.\(^\text{17}\)

2.3. **Invalidity.** A proof of mistake, incompetency, coercion, fraud, concealment, misrepresentation, duress and the like can defeat the enforceability of a guaranty.

2.4. **Void Obligation.** If the principal obligation is void, such as because it is illegal or unenforceable, the guaranty would fail. But if the principal obligation is merely voidable, then the guarantor is not entitled to raise that defense.\(^\text{18}\)

2.5. **Death of Guarantor.** Death does not automatically revoke a guarantor’s obligation unless expressly provided. But contrary to the assumption that a guaranty would continue unaffected by death, it appears that, if the amount and probability of liability is uncertain, the Pennsylvania Probate Court is in a position under the Probate Code to fix a number (which may be far less than the amount guaranteed), set that aside, and then permit the estate to distribute the balance of the assets free of the contingent liability. The reason for this power is to enable an estate to be liquidated rather than keep an estate open for an indefinite period of time until the amount and fact of liability becomes fixed.

2.6. **Due on Death.** In some printed forms of notes, there is a provision to the effect that the note becomes due upon the death of any personal guarantor. The reason for this provision is to establish that there is a liability and the guaranty becomes fully operative upon default. It fixes the amount (the obligations due at death), in order to get around the uncertainty problem which would otherwise exist.

2.7. **Discharge by Creditor Discharge of Guaranty.** A guarantor may prove the obligee released the guarantor. The release can be express. It can be the result of abandonment.\(^\text{19}\) It can result from impairment of the guarantor’s rights. Rights of the guarantor that can be impaired, waive, include:

2.7.1. subrogation,

2.7.2. bad faith,


\(^{17}\) 38 AM. JUR. 2d Guaranty § 32.

\(^{18}\) 38 AM. JUR. 2d Guaranty § 50.

\(^{19}\) 38 AM. JUR. 2d Guaranty § 80.
2.7.3. concealment of material facts or incomplete disclosure or risk,

2.7.4. material alteration of the principal obligation\textsuperscript{20}

2.7.5. impairment of collateral

2.7.6. Creditor taking a new note from debtor

2.7.7. Extension of maturity\textsuperscript{21}

\textsuperscript{20} William Schluderberg-T.J. Kurdle Co. v. Trice, 198 Va. 85, 92 S.E.2d 374 (1956). The guarantee explicitly stated that the guarantor would only provide the guarantee as long as the borrower’s indebtedness remained less than or equal to $2,500. 38 Am. Jur. 2d Guaranty §83. “§ 83. Alteration of principal obligation—Particular changes in contract

Alterations of the contract between the parties to the principal obligation which may cause the release or discharge of the guarantor include—

— the addition of a new party.
— a change in the place of payment.
— a change in the method of payment.
— a change in the rate of interest (whether an increase or decrease) which the debtor is obligated to pay to the creditor.
— restructuring the guaranteed debt after the guarantor had revoked the guaranty as to any new debt.
— an increase in the principal amount of a guaranteed mortgage note.
— an extension of credit beyond the limit stated in the underlying loan agreement.
— a renewal of the principal obligation.
— extending the time to pay the principal obligation.
— requiring the debtor to make a prepayment not contemplated in the original underlying principal agreement.
— a change in the ownership of the principal creditor or party guaranteed.
— a change in the ownership of the principal debtor where the lender acquired the debtor then released the debtor from the guaranty without the guarantor's consent.

On the other hand, changes to the principal obligation held not to release the guarantor include—

— formalistic changes in the identity of the principal obligor.
— changes made as part of a confirmed bankruptcy reorganization plan.
— a change in the way the creditor-bank calculated the "prime rate" upon which the interest rate on the guaranteed loan was based.

An extension of additional credit beyond that authorized in the note itself, where the lender did not attempt to collect more from the guarantor than the note's limit or where the creditor was aware the limit was being exceeded but did not protest.

— a renewal loan to the incorporated successor of the partnership which was the debtor under the original note, where the guaranty applied to renewals, although there is contrary authority.”

\textsuperscript{21} see also Restatement of Suretyship 3rd §33. “Except as provided in §34, a secondary obligor is discharged from the secondary obligation to the extent that the obligee, acting alone or in conjunction with the principal obligor or any other person, takes an action that would otherwise cause the secondary obligor a loss by impairing the ability of the secondary obligor to have the principal obligor bear the cost of performance owed to the obligee. Such impairment may be caused by:

(a) Release of the principal obligor with respect to the underlying obligation, as further described in §36; or

(b) Extension of time granted to the principal obligor to perform the underlying obligation, as further described in §37; or

(c) Other modification of the underlying obligation, as further described in §38; or
2.7.8. Failure to perfect

2.7.9. Release, postponement or novation of substitute obligor

2.7.10. Additional defenses can include impairment of right of recourse or subrogation, failure to comply with law.

2.8. Defenses of the Surety. By contrast to the guarantor, who has an independent contract and therefore does not on its face adopt the obligations of the debtor nor the debtor's defenses, the surety has primary liability with the debtor.

2.9. Discharge by Operation of Law. There are several circumstances where the guarantor is released from liability based on operation of law, such as the following:

2.9.1. Debtor's assignment to creditors, as distinct from its bankruptcy

2.9.2. Creditor's failure to achieve a deficiency judgment on the recovered value of the collateral

2.9.3. Foreclosure sale of collateral which destroys guarantor’s right of subrogation.

2.10. Statute of Limitations. Guarantor is not released due to Lender failure to take action against Borrower before the expiration of the statute of limitations “The secondary obligor’s rights and duties with respect to the principal obligor and the obligee are the same as if, on the day that the statute of limitations expired, the obligee had released the principal obligor . . . without preserving the secondary obligor’s recourse against the principal obligor” and

(d) Impairment of collateral or other security for the underlying obligation, as further described in §39; or

(e) Refusal of tendered performance, as further described in §40; or

(f) Failure to disclose events giving the secondary obligor the power to terminate the secondary obligation, as further described in §41; or

(g) Any other action that impairs the principal obligor’s duty of performance, the principal obligor’s duty to reimburse, or the secondary obligor’s right of restitution or subrogation.”

See Venaglia v. Kropinak, 956 P.2d 824, 833-835 (N.M. Ct. App. 1998) in which the New Mexico Supreme Court held that the guarantor’s defense that he was fully discharged from his guarantee because of the Settlement agreement between the borrower and the noteholder prejudiced his rights as guarantor finds support in section 44 of the Restatement of Suretyship, stating that “the proposition set forth in section 44 captures the principle underlying the more-specific propositions set forth in . . . sections §§39-43 of the Restatement.” In dicta, the court interpreted Article 3 of the UCC not to preclude the common law defenses preserved in section 44 of the Restatement. Id. at 834-835.

23 Union Bank v. Gradsky, 265 Cal. App. 2d 40, 44-48 (1968); 2. RESTATEMENT OF SURETYSHIP 3d, §33(g).


26 38 AM. JUR. 2d Guaranty § 96.

27 THE RESTATEMENT OF SURETYSHIP, §50.
"Accordingly, the principal obligor is discharged from duties to the secondary obligor ... and the secondary obligor is discharged from duties to the obligee."  

2.11. Joint Guarantors. When one guarantor pays more than its "proportionate share," it is entitled to retribution from the other guarantors.

2.12. Preventive Provisions. Some lenders, in an effort to avoid overreaching and lender liability attendant to that, have tempered their all encompassing domination of the guarantor by stating they are exercising enough self-restraint to avoid pushing the guarantor into bankruptcy by using language like the following:

"Notwithstanding the definition of indebtedness herein, the liability of each guarantor hereunder is limited to the lesser minus $1 (one dollar) of the lowest amount that would render this guaranty void, voidable, or otherwise unenforceable against creditors or creditors’ representative under any fraudulent conveyance or similar act or under Sections 433 or 548 of the Bankruptcy Code."

2.13. Fraudulent Conveyance. When a guaranty is made by a parent or subsidiary entity, there is a risk that the guarantor would later claim, or its creditors would claim there was inadequate consideration. One way of addressing that is by proving an integration of interests and benefits to guarantor from borrower’s loan. Leverage such as the following can be used.

"Guarantor has a direct ownership interest of [ ]% and financial interest in Borrower and Guarantor will benefit directly from the making of the Loan to Borrower."

This Recital attempts to serve several functions. First, substantially integrated 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, tantamount to a consent by Guarantor and therefore Guarantor’s liability remains intact. Second, this recognizes that guarantors, whose business is to provide guaranties, should not enjoy a technical defense to enforcement where the modification to the

28 Restatement of Suretyship, §43. But see Comment c to section 43, that if the Guarantor consents "expressly or impliedly" to the Lender’s action or waives suretyship defenses it prevents extinguishment of Guarantor’s obligations taken inconsistent either decidedly for discharge (See 825 S.W.2d 802 (Tex. App. 1992) or decidedly against discharge (See Bloom v. Bender, 313 P.2d 568 (Cal. 1957).

29 "The right to contribution among coguarantors arises from their implicit agreement upon executing the guaranty that each would contribute his just proportion of any liability, and stands on an equal footing with any other action found on an implied contract. The right to contribution is sometimes described as an equitable concept, subject to equitable defenses. A guarantor is entitled to contribution regardless of whether he and his coguarantors signed a single guaranty agreement or separate guaranty agreements." (footnotes omitted) 38 Am. Jur. 2d Guaranty § 121.

30 See Restatement of Suretyship, §§48(2) and 49(2)(a)(i). Comment c to §48, "[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."

31 Restatement of Suretyship, §49 is in line with UCC §3-605(c) and (d).
Guarantor’s obligation is non-material. Third, unless the Guarantor demonstrates prejudice caused by impairment of recourse or circumstances making the amount of loss difficult to calculate, this Recital would allocate to Guarantor the burden of persuasion as to loss or prejudice caused by Lender’s act.

2.14. **Ineffective Waiver.** Lender’s routinely provide for broad and unconditional waivers:

> “Guarantor waives any other circumstances, occurrence or condition, whether similar or dissimilar to any of the foregoing, which might otherwise constitute a legal or equitable defense, discharge or release of a guarantor or surety. If Borrower defaults under the Loan Documents and Lender is prevented from accelerating or collecting payment under the Note and other Loan Documents (whether because of Borrower’s Bankruptcy or any other reason), Lender shall be entitled to receive from Guarantor, upon demand by Lender, the sums which would have otherwise been due and payable had such acceleration occurred and had Lender been permitted to collect such sums from Borrower.”

They are also frequently attacked as ineffective. But if clearly waived, the Lender general prevails.  

2.15. **Subrogation.** The waiver of the destruction or impairment of a surety’s right of subrogation to unimpaired collateral must be unequivocal before it will effectively preclude a guarantor from asserting the defense noting that such right does not originate in contract but in law.

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32 See **Restatement of Suretyship, §44** as to enforceability of the Guaranty notwithstanding Lender’s impairment of Guarantor’s recourse against the Borrower.

33 **Restatement of Suretyship §48(1)** 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 §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.” *Restatement of Suretyship Comment d to §48. 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. Guarantor waives all defenses based on suretyship.*

"Guarantor agrees that it shall have no right to be subrogated to Lender’s interest in the Loan Documents until all amounts owing to Lender have been paid in full. Guarantor’s aforesaid right of subrogation shall be Guarantor’s sole remedy against Borrower, and Guarantor hereby waives any right to indemnification that Guarantor may have against Borrower. Guarantor understands and agrees that the exercise by Lender of certain rights and remedies contained in the Loan Documents may affect or eliminate Guarantor’s right of subrogation against Borrower and that Guarantor may therefore incur a partially or totally non-reimbursable liability under this Agreement; nevertheless, Guarantor authorizes and empowers Lender to exercise, in its sole discretion, any right and remedies, or any combination thereof, that may then be available to Lender, since it is the intent and purpose of Guarantor that the obligations hereunder shall be absolute, independent and unconditional under any and all circumstances."

[ALTERNATE OF SUBROGATION – “Nothing contained in this Agreement shall be construed to give Guarantor any right of subrogation in and to the Loan Documents or all or any part of the Lender’s interest in the Loan Documents until all amounts owing to Lender have been paid in full.”]

3. TYPES OF GUARANTIES

3.1. Absolute Unconditional and Continuing Guaranty. A guaranty without conditions with revocation effective only as to new debt. Corporate, real estate or personal guaranties can all be drafted to be “absolute, unconditional and continuing”, and even a limited guaranty may in some circumstances have these characteristics (for example, a guaranty limited as to the guaranteed amount – a certain dollar figure, or a figure in excess of a benchmark, for example, could be “absolute, unconditional and continuing” as to the Guarantor’s obligations with respect to such specified debt amount). When unconditional, the status of the Borrower, even its bankruptcy, does not affect the obligation of the Guarantors.35

3.2. Accommodation Guaranty. A guaranty without separate consideration to the guarantor.

35 Despite the fact that the Guaranty Agreements were part of a highly structured transaction and were intended to impose adverse consequences on the Guarantors for committing any ‘bad boy’ acts, the contract question is a straightforward one. The state court action is, as was argued by Bank of America at the Hearing, a standard contract case between two non-debtors that arises under New York law. (Tr.15:3-5). Such a case does not present bankruptcy issues and does not arise under the Bankruptcy Code. * * * Upon reading the Guaranty Agreements, it is clear that Bank of America’s claim in the state law action is entirely independent of any claims Bank of America may have against the Debtors. Section 1.1 of the Guaranty Agreements provides, in relevant part, that each of Lightstone and Lichtenstein “hereby irrevocably and unconditionally covenants and agrees that it is liable for the Guaranteed Obligations as a primary obligor.” (Memorandum Supp. at p. 3). Moreover, the Guaranty Agreements, at § 1,10, specifically provide that Lightstone and Lichtenstein have no right of offset or indemnity against the Debtors. (memorandum Supp. at p. 4). Accordingly, Bank of America’s efforts to recover the guaranteed obligations stand on their own and do not directly impact the Debtors.” In re Extended Stay Inc., et al, U.S. Bankr. S.D.N.Y, Case No. 09-13764 (JMP)
3.3. **Antifraud or Fidelity Guaranty.** A guaranty where a third party warrants that the information provided to the Lender on which the Lender relied is true and accurate. The liability of the guarantor only arises upon breach of such representations and the occurrence of loss to the Lender. In these types of guaranties, it is important that the guaranty clearly indicate the reliance.

3.4. **Bottom or Last Dollar Guaranty.** A limited guaranty which remains in existence until the last money outstanding is paid.

"**Limitation of Liability of Guarantor.** Notwithstanding anything to the contrary contained in this guaranty or any other Loan Document, the liability of Agreement hereunder shall not at any time exceed, and Lender agrees that it will not seek personal or general recourse against Guarantor for the payment or collection of any Obligations guaranteed hereby in excess of, an amount (the "Maximum Recourse Amount") equal to the lesser of (a) $[ ], or (b) the outstanding unpaid amount of the Obligations after giving effect to any payments or credits to which Borrower may be entitled by law, upon any sale of the Real Estate Property or otherwise, it being the intention hereof that neither (i) payment of any portion of the Loan, whether by voluntary prepayment, required amortization or otherwise, nor (ii) satisfaction or discharge of any portion of the Loan, whether by foreclosure, delivery of a deed in lieu of foreclosure, sale of the Real Estate Property or otherwise, shall be deemed to otherwise discharge all or any portion of Guarantor’s liability hereunder, except to the extent, if any, that the outstanding amount of the Obligations guaranteed hereby remaining unpaid shall be less than the Maximum Recourse Amount. The foregoing limitation shall not limit Guarantor’s liability for any other sums due under this Guaranty, including, without limitation, interest, costs and expenses."

3.5. **Completion Guaranty.** A guaranty that a project will be completed timely and lien-free, sometimes extinguished at the issuance of a certificate of occupancy, usually difficult to enforce. Guaranty of damages for failure to complete timely and lien free is the implied result. As one author recently noted, “lawyers involved in construction financing have expressed concerns regarding the practical benefit of completion guaranties. The current recession will likely provide an environment in which some of those concerns are put to the test.”

3.6. **Cross-Stream Guaranty.** A guaranty by one affiliate of another affiliate’s obligations, subject to the same legal deficiencies as an upstream guaranty.

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36 If limited to collection; this provision would create a “last dollar” or “bottom” guaranty to be effective only if Lender can prove it cannot collect the Obligation’s final dollars.

3.7. **Downstream Guaranty.** A guaranty by parent or owner of Obligor. Usually more safe from claims of inadequate consideration to the owner than an upstream guaranty because payments by the owner increases its equity in the Obligor by reducing debt of the Obligor. But the theory has been successfully challenged where the debt far exceeds the value of the Obligor, and therefore the owner never had meaningful equity. There was also a preference argument upon an Obligor’s bankruptcy that the owner (1) was an insider, (2) knew of Obligor’s insolvency at least a year before filing, (3) was benefitted as a creditor of Obligor by payments to lender because owner’s liability was reduced, and therefore (4) payments to lender were preferential payments as to the Lender as to 90 days of debt service and as to the Guarantor for one year’s debt service who would have to pay that amount to the debtor’s estate. 38

3.8. **Exploding Guaranty.** A guaranty which is partial or limited but becomes general and personal if the guarantor breaches specific covenants, usually interfering with Lender’s efforts to exercise remedies.

“Notwithstanding the foregoing to the contrary, Lender shall not proceed against Guarantor under this Agreement unless and until (i) Borrower files a voluntary petition in bankruptcy, or (ii) Lender commences a foreclosure action under the Mortgage or seeks to obtain or execute upon a judgment on one or more of the Notes or to confess or execute upon a judgment on one or more of the Notes or to confess or execute upon a judgment under the Mortgage or one or more of the Notes and such action is contested by Borrower, Guarantor, any other guarantor of the Obligations, or any individual or entity affiliated or related thereto; provided that, in the event Borrower raises what Borrower in good faith believes to be a valid defense to such an action, Lender shall not pursue Guarantor until such defense is disallowed, provided further that if such defense is disallowed, Lender may immediately proceed against Guarantor under this Agreement and this Agreement shall not be deemed terminated upon the transfer of the Premises.”

3.9. **Good Guy Guaranty.** A variant of the Exploding Guaranty, in which the credit-worthy guarantor’s obligation ends upon the Borrower or Tenant quietly surrendering by giving back the property. Sample language such as:

“Nothwithstanding anything to the contrary contained in this guaranty, the guarantor’s liability shall be limited to the amount of unpaid debt service installments (not accelerated principal), with interest at the Default Rate and without requirements of prior application of any other security held by the Lender, through and including the date that Borrower cooperates with Lender and surrenders possession to lender of the Mortgaged Premises free from claims of entitlement to occupancy or ownership by the Borrower or any other party.”

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38 [ ]
3.10. **Indemnity.** The indemnity language is usually reactive, after the loss is suffered. The Indemnitor would look to qualify it in several ways. To limit its effect to instances of loss caused by the Indemnitor, or its negligence or its malicious acts, and not due to Indemnitee, or its negligence or its malicious acts. Indemnitor would also look for a protocol for implementing the indemnification.

"Indemnitor’s obligation to indemnify, defend, and hold harmless is subject to and limited by the following:

(a) Indemnitee providing prompt notice containing a description of the claim and nature and the amount of the loss;

(b) Indemnitee not contributing to the loss by bad faith, gross negligence or willful misconduct;

(c) Indemnitee mitigating any loss upon becoming aware of any event which would require indemnification, to the extent solely in Indemnitee’s control, or promptly notifying Indemnitor of the opportunity to mitigate to the extent mitigation can be performed by Indemnitor or parties other than Indemnitee;

(d) Indemnitee attempting to make recovery of the loss from insurance or other sources of payment which would otherwise cover such loss, to the extent solely in Indemnitee’s control;

(e) Indemnitee not admitting liability, litigating, defending, settling, compromising or discharging any claim for which Indemnitor would be obligated to indemnify Indemnitee, unless with the Indemnitor’s prior reasonable consent;

(f) Indemnitee cooperating with the Indemnitor’s defense or prosecution; and

(g) the Indemnitor’s right to discharge, bond or insure over any lien imposed upon the Indemnitee’s assets in lieu of paying the amount liened."

3.11. **Last Out Guaranty (of Collection).** Guaranty to pay amounts due if not collected from Obligor after recovery effort by Lender, or if a recovery effort is not economically feasible, such as where the documents are deficient or the Borrower perpetrated a fraud.

3.12. **Limited Collateral Recourse Guaranty.** A guaranty can be secured by or limited to specific collateral.
“Anything in this Guaranty or in applicable law to the contrary notwithstanding, in the event of the enforcement of this Guaranty, any recovery against Guarantor will be limited to the assets listed on Exhibit A attached hereto and made apart hereof. If all or a material portion of an asset listed on Exhibit A is, after the date of this Guaranty, Transferred or Encumbered, Guarantor will, within 30 days after the Transfer or Encumbrance, replace the asset transferred or encumbered (the “Transferred Asset”) with an asset of Substantially Equivalent Value, which will then become part of Exhibit A. If the Transferred Asset is not so replaced and the remaining assets shown on Exhibit A are insufficient to satisfy such Guarantor’s obligations under this Guaranty at the time of enforcement, then any other assets of Guarantor will be subject to execution under this Guaranty, but only to the extent of the Substantially Equivalent Value of the Transferred Asset; excluding, however” each of the following assets: (i) the personal residence of such Guarantor; (ii) the interest of such Guarantor in ABC Ltd., a Texas limited partnership; (iii) the non-business real estate, including rural, vacation and resort property up to $500,000 in Fair Market Value of Guarantor; and (iv) the personal automobiles and other tangible personal property, including, without limitation, household goods, clothing, silverware, jewelry and works of art not to exceed $100,000 in Fair Market Value of Guarantor.”

3.13. Master Lease. This true lease is frequently used where the Borrower does not expect to meet the lease-up requirements under a loan, but can be used in other situation for credit enhancement. It may also be used to cover more speculative third party lease space such as food courts, push-carts, health clubs, or parking garage. It is the progenitor of the synthetic lease. Sometimes it is considered as a way to avoid frustration of enforcement of guaranties in one action states. Usually, the Guarantor leases but does not occupy property; therefore, it may be questionable whether it satisfies the loan requirement of “space leases” to “tenants in occupancy.” It is equivalent to a guaranty of cash flow except it requires current, not contingent or future, liability. The typical transaction format is as follows:

3.13.1. Borrower owns the real property collateral;

3.13.2. Borrower executes [a non-recourse] note to Lender, typically with a mortgage and sometimes with an assignment of rents;

39 In the case of Union Bank v. Gradsky, 265 Cal. App. 2d 40, 71 Cal. Rptr. 64 (1968), the court held that, following a non-judicial sale, the creditor could not recover a deficiency from the guarantor of the debt because the anti-deficiency statute would prohibit the guarantor from exercising the guarantor’s right of subrogation against the debtor. However, there are several reported cases in which the California courts have had to decide whether to recharacterize other types of agreements as guaranties. The analysis used by the court was to look at how closely the obligations under the agreement match the obligations under the loan. See, Union Bank v. Winnebago Industries, Inc., 528 F.2d 95 (9th Cir. 1975); United California Bank v. THC Financial Corp., 557 F.2d 1351 (9th Cir. 1977); and United California Bank v. Maltzman, 34 Cal. App. 3d 41, 118 Cal. Rptr. 199 (1975).
3.13.3. A creditworthy Principal of the Borrower enters into a Master Lease with Borrower for all or a portion of the property;

3.13.4. Borrower assigns to Lender rent from Master Lease.

3.13.5. Principal grants Lender an assignment of sublease rentals;

3.13.6. Principal either grants Lender a conditional assignment of Principal’s interest as a tenant in the master lease or enters into an SNDA with Lender.

3.13.7. **Virtual Credit Enhancement.** A master lease may provide effective third party credit enhancement. The structure can be equivalent to a guaranty of cash flow because the “rent” under the master lease can be made equivalent to the required debt service on the loan. This may be of particular use when the property is not expected to have full (or sufficient) occupancy early in the loan term. As third-party tenants lease or sublease space, the “master tenant” obligation can be reduced (or even eliminated). There are usually required conditions:

   (a) Approval by Lender of lease form, base rental rate, and term extending beyond loan term. Often, there is a preapproved lease form and certain preapproved rental parameters.

   (b) Occupancy of tenant.

   (c) Estoppel letter from tenant.

   (d) Evidence of completion of tenant finish and lien waivers.

   (e) Certificate of Occupancy.

   (f) Subordination Agreement.

   (g) Solvency of tenant.

3.13.8. **Master Lease Defense.** A master lease may also contain a rent acceleration clause, effectively giving Lender another way to call the entire loan due upon default. On the other hand, the Master Lease may theoretically be subject to tenant defenses and/or landlord duties to mitigate damages. Since the landlord is the borrower in this scenario, this could place more strain on an already precarious – or even defaulting – borrower. Moreover, a master lease, like any lease, is potentially subject to rejection by a debtor-in-possession in a bankruptcy, thereby further limiting Lender’s potential recovery. The Master Lease generally is “bondable” in format: no right of termination, even upon total loss due to casualty, condemnation, or failure of title.

3.13.9. **Master Lease Characterization Issues.** The benefits and drawbacks of using a master lease to effect a guaranty of a debt highlight the possible tension between the “tenant” (in effect, the Guarantor) and the Lender: the former may wish to recharacterize it as a guaranty to take advantage of guarantor-type discharges, the latter may want to characterize it as
a guaranty but for the opposite purpose, to avoid real property type defenses. The IRS and/or a trustee in bankruptcy may have their own reasons to [re-] characterize a master lease as a lease or a guaranty: for example, the IRS may prefer a guaranty characterization to limit the “tenant’s” ability to claim “rent” deductions as a means of expensing principal payments; a trustee or creditors in bankruptcy may point out that a lease may be rejected as an “executory contract”, whereas a “guaranty” may not; a lease rejected by a landlord in bankruptcy may entitle the tenant to retain possession of the premises. Finally, availability of statutory defenses may also inform the particular characterization of a Master Lease as a guaranty.

3.14. Non-Recourse Guaranty. Generally, a pledge of collateral by Guarantor, but no general liability of guarantor – that is, the lender’s recourse against the guarantor is limited to the Guarantor’s interest in the guarantor collateral against the guarantor, and not to other assets. Lenders may expand and rely increasingly on “carve-outs” to non-recourse provisions, including so called “bad boy” acts. Among such carve-outs that may be regaining greater currency in these times are actions amounting to “waste” – whether physical or economic (for example, the failure to satisfy real property taxes, leading to potential impairment of the collateral by reason of the imposition of tax liens).

Notwithstanding the foregoing, Guarantor, jointly and severally, shall have full personal liability (i) for the payment of ad valorem taxes assessed against the Property; (ii) for the payment of all hazard and liability insurance premiums for the Property; (iii) for the breach of any covenants and warranties made to Lender herein and those covenants in the Security Instruments executed at closing which pertain to facts existing at closing which are relied upon by Lender in making the Loan; (iv) for the payment of all sums due and payable to Lender under the Equity Participation Agreement, and (v) for all Deferred Interest. Additionally, nothing herein contained shall limit or be construed to limit the personal liability and obligations of Borrower or any Guarantor to the event that, after a default shall have occurred under the Loan, Borrower or any Guarantor shall collect any rents, issues or profits from any of the Property and shall not apply the same to the normal operating expenses of the Property and/or any payments due under the Note in compliance with the terms of the Note and/or Deed of Trust, it being intended hereby that Borrower and each Guarantor shall have full personal and partnership liability and be obligated to the full extent of such rentals, issues, profits, and other items collected after a default under the Loan and not applied to said normal operating expenses and payments due under the Note in compliance with the terms of the Note and/or Deed of Trust, and that Lender shall not be limited in any way in enforcing such liability and obligation.

3.15. Note Purchase or “Put” Agreement. Where a guarantor is obligated to purchase the Loan. It is equivalent to a guaranty of principal, interest and performance of future covenants.
3.16. **Operating Deficit Guaranties.** A guaranty to pay project expense shortfalls, which may or may not include debt service.

3.17. **Out of Formula Guaranty.** A guaranty for obligations in excess of a specific amount. The provision should address whether the guarantor’s obligation becomes fixed in the event an overadvance is made or whether the obligation becomes extinguished in the event the out-of-formula situation is cured. The latter may not be beneficial to a Lender if the out-of-formula situation is cured by payment of the better receivables and, even though the out-of-formula situation no longer exists, the lender is now left with a different or lesser mix of collateral and yet with no liability on the part of the Guarantor. The lender may want the guaranty, when it becomes effective, to become fixed and effective for all obligations, even if the over-line or overadvance situation gets cured. The Lender may agree, however, that the guaranty will only become effective as to the amount of the overcredit-line advances or the over-formula advances. Whether this type of limitation effectively protects the Lender will depend on the reasons why the lender was reluctant to make the overadvance and its general underwriting of the credit.

3.18. **Reducing Guaranty.** A guaranty which diminishes. If it is based on payments, the application of the payments should be carefully identified: is it principal, interest, other charges. And if the Lender has identified the Loan as non-accruing for internal or regulatory purposes, can the payment application be deemed an interest payment.


3.20. **Snap-Back, Claw-Back, or Springing Guaranty.** A guaranty which is extinguished unless certain conditions subsequent occur, which usually are based on no interference with Lender’s exercise of its remedies.

3.21. **Stand-by Letter of Credit.**

3.21.1. **Benefit to Lender.** Permits Lender to be paid in full, equivalent to a guaranty by the issuing bank to pay upon receipt of certificate of default. Better liquidity than cash collateral because insulated from bankruptcy.

3.21.2. **Structure.** Letters of Credit (“LOCs”) are commonly used to substitute the credit of the Borrower with that of the issuing bank. In the typical formulation, the Borrower or its creditworthy principal enters into an LOC agreement with the issuing bank under which the bank will pay over funds to Lender upon a sight draft and demand statement. This “sight draft” arrangement does not require the issuing bank to verify Lender’s claims and usually contains built-in protection for the issuing bank against claims arising out of its payment of funds to the Lender in compliance with the terms of the LOC. The Borrower and/or creditworthy principal is then obligated to reimburse by separate Reimbursement Agreement the issuing bank.

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3.21.3. Limitations. Like other types of credit support, LOCs can be limited in some ways, though they are less flexible than other types of guaranties. The LOC can have a specific term, it can be revocable under certain circumstances, and it can be “reducible” by partial draw downs.41

3.22. Top or First Dollar Guaranty. The first money collected by Lender reduces the guaranty, and it can be extinguished upon collection of a specific amount or percentage of the obligation.

“The term “Guaranteed Indebtedness” means . . . (i) the [ ] ( ) of the first amount to be paid of principal funded by Lender under the Loan Agreement at any one time; (ii) [ ] ( ) percent of interest accruing but unpaid on the principal balance of the loan (including, if applicable, interest at the ( ) of Lender Expenses. All payments (whether by regular monthly installments, prepayments, foreclosure proceeds and/or recoveries from other Guarantors) made on the Loan shall be credited, to the extent of the amount thereof, in the following manner:

(i) first, to the payment of the portion of the Lender Expenses as to which Guarantor is personally liable;

(ii) Second, to the payment of that portion of the Lender Expenses as to which Guarantor is not personally liable;

(iii) third, to that portion of accrued but unpaid interest: as to which Guarantor is personally liable;

(iv) fourth, to that portion of accrued but unpaid interest as to which Guarantor is not personally liable;

(v) fifth, to that portion of the principal balance of the Loan as to which Guarantor is Personally liable; and

(vi) sixth, to that portion of the principal balance of the Loan as to which Guarantor is not personally liable.

Top guaranties have significant issues relating to when and how the formula of “top percentage” should be applied

(a) Whether regular payments, prepayments, foreclosure gross proceeds, recoveries from sources other than borrower (such as other guarantors or credit enhancers);

41 Where a guaranty provided that it ‘shall be reduced to the extent of any principal paydown on the Obligations’ and does not specify that the paydown need be made by the principal obligor nor does it limit the paydown to moneys paid in the ordinary course of monthly installments, the Lender was obligated to credit foreclosure proceeds against the principal of the debt. Further, a guaranty applied to the first dollars recovered of the debt so that if the foreclosure proceeds exceeded that amount, the guaranty was extinguished. Bank E. v. Michalenoick, 1994 N.H. LEXIS 31 (N. 1994)
(b) Whether the top percentage is determined on loan closing date, default date, foreclosure date or judgment date.

(c) Whether it guaranties only principal or also late charges, default interest, and/or collection fees.

3.23. **Upstream Guaranty.** A guaranty by an entity of its owner’s (parent’s) debt. The risks are: no consideration, if guarantor is made insolvent by payment on the guaranty, it may be subject to set-aside; could be deemed dividend to Obligor at time of payment.

3.24. **Warranty.** A guaranty which some believe is absolute, unconditional and primary, permitting the related contract, if any, to be voided; as compared to a guaranty which is conditioned upon performance of a related contract, and for which liability arises only if the obligor fails to perform.
ATTACHMENT A

Cited Sections from Revised UCC §3-605

(c) Agreement to extension of due date.—If a person entitled to enforce an instrument agrees, with or without consideration, to an extension of the due date of the obligation of a party to pay the instrument, the extension discharges an endorser or accommodation party having a right of recourse against the party whose obligation is extended to the extent the endorser or accommodation party proves that the extension caused loss to the endorser or accommodation party with respect to the right of recourse.

(d) Agreement to material modification.—If a person entitled to enforce an instrument agrees, with or without consideration, to a material modification of the obligation of a party other than an extension of the due date, the modification discharges the obligation of an endorser or accommodation party having a right of recourse against the person whose obligation is modified to the extent the modification causes loss to the endorser or accommodation party with respect to the right of recourse. The loss suffered by the endorser or accommodation party as a result of the modification is equal to the amount of the right of recourse unless the person enforcing the instrument proves that no loss was caused by the modification or that the loss cause by the modification was an amount less than the amount of the right of recourse.

(e) Impairment of collateral; discharge of endorser or accommodation party.—If the obligation of a party to pay an instrument is secured by an interest in collateral and a person entitled to enforce the instrument impairs the value of the interest in collateral, the obligation of an endorser or accommodation party having a right of recourse against the obligor is discharged to the extent of the impairment. The value of an interest in collateral is impaired to the extent the (i) value of the interest is reduced to an amount less than the amount of the right of recourse of the party asserting discharge or (ii) the reduction in value of the interest causes an increase in the amount by which the amount of the right of recourse exceeds the value of the interest. The burden of proving impairment is on the party asserting discharge.

(f) Impairment of collateral; discharge of party jointly and severally liable.—If the obligation of a party is secured by an interest in collateral not provided by an accommodation party and a person entitled to enforce the instrument impairs the value of the interest in collateral, the obligation of any party who is jointly and severally liable with respect to the secured obligation is discharged to the extent the impairment causes the party asserting discharge to pay more than that party would have been obliged to pay, taking into account rights of contribution, if impairment had not occurred. If the party asserting discharge is an accommodation party not entitled to discharge under subsection (e), the party is deemed to have a right to contribution based on joint and several liability rather than a right to reimbursement. The burden of proving impairment is on the party asserting discharge.

(g) Other limitations on discharge.—A party is not discharged under this section if:
(i) The party asserting discharge consents to the event or conduct that is the basis of the discharge; or

(ii) The instrument or a separate agreement of the party provides for waiver of discharge under this section either specifically or by general language indicating that parties waive defenses based on suretyship or impairment of collateral.
§43. Delay in Enforcement; Running of Statute of Limitations on Underlying Obligation.

Notwithstanding §50, if the obligee fails to institute action against the secondary obligor on the secondary obligation until after the obligee’s action against the principal obligor on the underlying obligation is barred by the running of the statute of limitations as to that action, the secondary obligor’s rights and duties with respect to the principal obligor and the obligee are the same as if, on the day that the statute of limitations expired, the obligee had released the principal obligor from its duties pursuant to the underlying obligation without preserving the secondary obligor’s recourse against the principal obligor. Accordingly, the principal obligor is discharged from duties to the secondary obligor as provided in §39(a), and the secondary obligor is discharged from duties to the obligee as provided in §39(c)(ii) and §39(c)(iii).

§44. Other Impairment of Recourse.

If otherwise than described in §§39-43, the obligee impairs the principal obligor’s duty of performance (§21), the principal obligor’s duty to reimburse (§§22-25), or the secondary obligor’s right of restitution (§26) or subrogation (§§27-31), the secondary obligor is discharged from its duties pursuant to the secondary obligation to the extent that such impairment would otherwise cause the secondary obligor a loss.

§48. Waiver of Suretyship Defenses; Consent.

(1) The secondary obligation is not discharged under §39(c)(ii)-(iii), §40(b), §41(b)(ii), §42(1), §43, or §44 to the extent that, in the contract creating the secondary obligation or otherwise, the secondary obligor consents to acts that would otherwise be the basis of the discharge, agrees that such discharges are unavailable to the secondary obligor, or waives such discharges. Consent may be express or implied from the circumstances. Such consent, agreement, or waiver, if express, may be effectuated by specific language or by general language indicating that the secondary obligor waives defenses based on suretyship.

(2) Unless the circumstances indicate otherwise, when the secondary obligor either controls the principal obligor or deals with the obligee on behalf of the principal obligor, consent by the principal obligor to an act that would lead to discharge under §37 constitutes consent to that act by the secondary obligor.

§49. Burden of Persuasion with Respect to Impairment of Recourse.

(2) Except as provided in subsection (3), the burden of persuasion with respect to loss or prejudice caused by an obligee’s act impairing the secondary obligor’s recourse against the principal obligor is allocated as follows:

(b) The burden of persuasion is on the secondary obligor if:
The secondary obligor is in the business of entering into secondary obligations, received a business benefit for entering into the secondary obligation, or otherwise was induced to enter into the secondary obligation by separate consideration that directly benefits the secondary obligor; or

(ii) The act impairing recourse is a modification of the underlying obligation, unless the secondary obligor establishes that the modification is material;

(a) Otherwise, it is presumed that the act impairing recourse caused a loss or impairment equal to the secondary obligor’s liability pursuant to the secondary obligation and the burden of persuasion as to the nonexistence or lesser amount of such loss is on the obligee.

(3) Notwithstanding subsection (2)(a), if:

(a) The secondary obligor demonstrates prejudice caused by the impairment of recourse; and

(b) The circumstances of the case indicate that the amount of loss is not reasonably susceptible of calculation or requires proof of facts that are not ascertainable,

it is presumed that the act impairing recourse caused a loss or impairment equal to the secondary obligor’s liability pursuant to the secondary obligation, and the burden of persuasion as to any lesser amount of such loss is on the obligee.


(1) Delay by the obligee in taking action against the principal obligor with respect to the underlying obligation, or failure of the obligee to take such action, does not discharge the secondary obligor with respect to the secondary obligation except as provided:

(a) By applicable statute;

(b) By agreement of the parties;

(c) in Section 43 of this Restatement; or

(d) In Subsection (2) of this section.

(2) If the failure of efforts by the obligee to obtain satisfaction of the underlying obligation is a condition of the secondary obligor’s duty under the secondary obligation, the secondary obligor is discharged to the extent that the obligee’s failure to act with reasonable promptness against the principal obligor is the cause of the obligee’s inability to collect from the principal obligor.
ATTACHMENT C

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