Drafting an Enforceable Guaranty in an International Financing Transaction: A Lender’s Perspective

by
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A guaranty is valuable to a lender only if it is enforceable. This article provides practical advice for lenders on how to draft enforceable guaranties. Particular attention is given to the special problems of guaranties in international financial transactions. Recent developments in American case law also are considered.

The article explains the language of guaranties, examining the legal implications of such terms of art as “absolute,” “irrevocable,” and “continuing.” The author suggests language that lenders can use to preclude legal challenges. Precise drafting, for example, can avoid defeat of a guaranty contract for lack of consideration, or loss to a lender due to guaranties being paid in a different currency. The author provides further advice on other issues that may arise with regard to guaranties such as choice of law and tax indemnity.

I. INTRODUCTION

By definition, a guaranty is an agreement whereby one person promises to pay the debt or perform the obligations of another person.1 In theory, therefore, the guaranty is an effective means to lessen a bank’s risk when a loan becomes unrecoverable from a borrower.

The real value of a guaranty, however, is determined by whether it is enforceable.2 If the lender finds it difficult or impossible to collect under the guaranty, the value of the guaranty is considerably reduced. Recent cases

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2. Often enforcement means litigating the validity of the guaranty. Even though a guaranty may not be subject to litigation, the guarantor’s expectation that it is irrevocably liable for the obligations of the principal or that its good name is in jeopardy if it fails to meet its obligations is often equally important if the lender is to be repaid.
have tested the enforceability of this traditional method of protecting a bank's capital investment, and the results have not always favored the lender. Indeed, these cases have given rise to a mistaken view by some that a guaranty that accompanies a secured loan is a less than essential component of the security package.\(^3\) Lenders and lawyers have encountered other problems of enforceability that encourage skepticism as to the utility of guaranties.\(^4\)

Yet problems of enforcement should not belie the importance of guaranties. As with any contract, a party to an agreement may attempt to evade the reasonably incurred obligation, if the contract has become economically or otherwise unfavorable to the evading party. If a debtor defaults on a loan, a guarantor of the obligation will often in turn be reluctant to perform under the guaranty, especially if the lender has not exhausted every remedy it has against the debtor to recover its money. Some guarantors will challenge every aspect of the loan documentation in the hope of finding some deficiency that will release them from their obligations under the guaranty. Nevertheless, a lender simply wants its money returned, which is what it bargained for, without having to resort to expensive means of recovering it.

As a result of such challenges, a myriad of law concerning the enforceability of guaranties has developed as reluctant guarantors have attempted to extricate themselves from their third-party obligations. This vast collection of case law offers guidance to drafters of debt guaranty contracts. And therein lies the hope of all lenders—precedent. Employing language that has already withstood court challenges and drafting carefully to forestall new challenges will lessen the chance of a guarantor obtaining a release and enhance the probability of the lender being made whole.

In the context of an international transaction, special problems exist. These include, among others, differing interpretations of terms used in guaranties, losses attributable to multiple currency payments (whether as a result of payments by the guarantor or awards on foreign court judgments), and the consequences of applicable foreign law.

This article will examine such problems from a lender's perspective. It will propose language or provisions that should be considered in drafting a guaranty for purposes of securing international lending transactions. How-

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3. In Levit v. Ingersoll Rand Fin. Corp., 874 F.2d 1186, 1187 (7th Cir. 1989)[hereinafter Deprizio], discussed supra part III, payments to a creditor by a debtor prior to bankruptcy were held recoverable by a bankruptcy trustee since the debt was guaranteed by an "insider" of the debtor. Creditors contended that an extended preference period would create a "stampede from workouts to bankruptcies." Id. at 1198.

4. For a variety of reasons the "guaranty" is often thought to represent the weakest portion of the security documentation used to secure a loan. It is seen to offer less protection than such instruments as mortgages, security agreements, pledges of stock, assignments, or in England, charges. Such views may persist because the assets of the delinquent guarantor may be unreachable for enforcement of the guaranty. An individual guarantor may be impossible to locate. It frequently happens that the guarantor has guaranteed so many obligations that its promise to pay is worthless.
ever, the discussion is equally applicable to other types of transactions and creditors requiring a guaranty of payment.

This article is not intended, however, merely to provide a checklist of the provisions to be incorporated in a guaranty. Rather, it analyzes the significance of the operative language found in guaranties and considers provisions that should be included. The suggested terms are useful either because the parties to the transaction are located in different countries or because recent developments in the law of guaranties necessitate their inclusion. In addition, Part III of this article discusses recent rulings by U.S. courts that have had a significant impact on the enforceability of guaranties. These cases highlight some of the dangers lenders confront in securing repayment under a guaranty. The discussion focuses on United States and English law, but the provisions discussed herein generally address problems a lender might encounter in most foreign jurisdictions. The intent of this article is to demonstrate that a guaranty should be given careful thought when a lender is choosing the appropriate security documentation to accompany a secured loan.

II. DRAFTING ENFORCEABLE GUARANTIES

Traditional methods of financing will continue to account for the majority of loans that are made in the United States and abroad. The decline in world financial markets, the multi-billion dollar failure of the savings and loan industry in the United States, and the general instability of the banking industry, as well as the decline in favor of such avant-garde methods of financing as junk bonds, have caused lenders to retrench and reexamine their portfolios and the way they conduct business. Faced with such problems, lenders are inclined to resort to safer methods of securing their loans rather than experiment with untested and risky methods of financing.

The guaranty is a traditional means for a lender to secure its financing. It is a unique agreement in that it binds a third party to pay if the principal debtor fails to pay. Case law in both England and the United States has contributed to the development of guaranty provisions that address a guaranty's enforceability. Under the documentary conventions of both England and the United States, these provisions, over time, have come to employ specific wording reflecting specific meaning and intent. Occasionally, however, courts may upset the meaning customarily associated with this guaranty nomenclature. As a result, a secured lender should periodically reexamine its standard form guaranty and the extent to which it uses guaranties. The document should reflect current law, effect current remedial provisions, and anticipate future legal developments.

5. The law of guaranties in the United States is generally a matter of contract law. Contract law is generally governed by the laws of each state. As a result, this article will focus on laws of the State of New York and the general principles of applicable law of the collective states of the United States.
Generally, a court will not redraft or augment the terms of a guaranty. Its terms will be strictly construed since a court is being asked to hold a third party liable for the debts of another. In most cases any error or oversight will be construed against the drafter, i.e., the bank. As a result, the terms of a guaranty should clearly express their intended meaning and purpose. However, as discussed below, court rulings occasionally diminish the ability of lenders to enforce guaranties. Confronted with such uncertainty, lenders should carefully consider the terms and wording of their guaranty to minimize the danger of invalidation or unenforceability.

An overview of the guaranty provisions employed in terms of international transactions may reveal the need to revise or reconsider outdated provisions. Typically, a guaranty will include: (1) the words of guaranty; (2) its conditional nature; (3) a description of the obligations guarantied; (4) its continuing nature; (5) the consideration given; (6) payment provisions; (7) a subrogation (contribution) provision; and (8) waiver language. In addition, a guaranty may contain, inter alia, an account provision, or in lieu thereof, a “cap” on the guaranty amount. In an international transaction the following provisions should merit special consideration: (1) a multi-currency provision; (2) an indemnification clause; and (3) a forum and governing law provision. Part II of this article will focus primarily on one type of guaranty, an absolute, unconditional, and continuing guaranty of payment and performance.

6. The rule of contra proferentem provides that an ambiguous provision in a contract is construed against the person who selected it. See BLACK’S LAW DICTIONARY 327 (6th ed. 1990).
7. Naturally, the provisions in a guaranty will be related to the type of transaction. As discussed in this article, for example, some guaranties may not be continuing in nature.
8. The account provision of a guaranty generally provides that a statement of certification as to the amount due or outstanding will bind the guarantor as to that amount. See 1 HOWARD RUDA, ASSET BASED FINANCING: A TRANSACTIONAL GUIDE § 11.12[7]-[9] (1985). It is an evidentiary tool designed to ascertain predictably the amount the guarantor is obligated to pay.
9. Other provisions that may be included in a guaranty but not discussed here include provisions for set-off, appointment of agent for service of process, waiver of jury trial, notices, application of proceeds clause, and covenants and representations of the guarantor.
10. Other types of guaranties include restricted or conditional guaranties. Others may have a definite date of maturity. A restricted guaranty is one limited to a particular transaction. If it is conditional, its effect is triggered on the happening of some event. A guaranty may be implied or expressed. Daughters of Sarah Nursing Home Co. v. Lipkin, 535 N.Y.S.2d 790 (N.Y. App. Div. 1988)(holding that son became guarantor by signing nursing home contract).
11. An absolute, irrevocable and continuing guaranty of payment and performance binds the guarantor third party to assume the borrower’s obligations under the loan agreement, including repayment of all amounts advanced to, and performance of all obligations incurred by, the borrower. Upon payment and/or performance by the guarantor to the secured lender of the borrower’s obligation, the guarantor may assume the role of the secured lender as a creditor and has all the rights of enforcement the secured lender had under the loan agreement. The guaranty essentially shifts the risk from the secured lender to the guarantor for non-performance or non-payment by the borrower.
A. Guaranty Nomenclature

A common form of guaranty sought by a secured lender, and examined in this article, is an “absolute,” “irrevocable,” and “continuing” guaranty by a person as “primary obligor” of the obligations of a debtor. This type of guaranty obligates a third party to pay the lender the sums required to make it whole if the borrower defaults. However, as the terms “absolute,” “irreversible,” and “continuing” suggest, the relationship between the lender and the guarantor under such an agreement is ongoing rather than limited. These standard terms help explain the obligations, duties, and rights of the guarantor vis-a-vis the lender and the borrower in guaranties of payment and performance. Through extensive use, these phrases have acquired certain connotations peculiar to the world of guaranty nomenclature. However, their specific meanings remain obscure and should be carefully defined within the body of the agreement.

Typical words of guaranty may state:
The Guarantor hereby unconditionally and irrevocably guaranties as primary obligor and not merely as surety, the full and prompt payment to the Lender on first demand of all indebtedness when due upon maturity, acceleration, or otherwise, and the performance by the Borrower of all of its obligations under the Loan Agreement.

1. Absolute Guaranty

The terms “absolute” and “unconditional” are generally deemed to be synonymous. An absolute guaranty means that there is no condition the secured lender must satisfy, nor are there remedies it must pursue against the borrower, prior to enforcing its rights against the guarantor under the guaranty. In the above example, this language is reinforced by including the phrase “on first demand.” However, the guaranty should contain further

12. In the case of an individual guarantor of corporate debt, it may be advisable not to indicate the guarantor’s status as a primary obligor, i.e., co-maker. Under New York law, an individual guarantor cannot plead usury as a defense if the debtor is a corporation prohibited by applicable law from pleading usury. See General Phoenix Corp. v. Cabot, 89 N.E.2d 238, 243 (N.Y. 1949). As a result, the guarantor may attempt to characterize himself as a co-borrower thereby being entitled to the defense of usury as an individual debtor and not a corporate debtor.

13. A revocable guaranty expires at a definite time or on the occurrence of an event or act. Questions of interpretation may arise when such a guaranty does not clearly specify its scope.

14. A guaranty of payment and performance is a guaranty that obligates a third party to pay or perform should the principal debtor default.

15. A provision specifying that the guaranty is one of payment should be included in connection with this clause in guaranties to be enforced under New York law in order to confirm that this type of guaranty represents the parties’ intent. In addition, a lender should be aware that a U.S. court has explicitly focused on the “absolute, unconditional” nature of a guaranty to bar the defense of fraud in the inducement. See BNY Fin. Corp. v. Clare, 568 N.Y.S.2d 65 (N.Y. App. Div. 1991).

16. Inclusion of “on first demand” reiterates the concept embodied in an absolute unconditional guaranty, that a demand for payment should neither be construed as a form of notice for late payment or warning of delinquency. Note that payment includes any sum due as a result of “acceleration” of the due date. Acceleration of a loan is usually triggered by default of the
language that clarifies the amorphous term "unconditional." For example, language to the effect that "the lender is not obligated to take any action or obtain any judgment, nor file any claim . . . prior to enforcing this guaranty" may be included within the guaranty to give further effect to its unconditional nature. 17

Because there are no conditions that must be met prior to enforcement by the lender of the guaranty upon default by the borrower, the guarantor in the above provision could be considered a surety, 18 or even a primary obligor. 19

2. Irrevocable Guaranty

The term "irrevocable" implies that a guaranty may not be rescinded by a guarantor. Its usage in guaranties is thought to be derived from the convention governing letters of credit according to which an agreement was presumed to be revocable unless it specifically stated that it was irrevocable. 20 However, the irrevocable nature of a guaranty is properly linked to the consideration given. If adequate consideration has been given and accepted, the guarantor is bound by the terms of its agreement, barring breach of contract. 21

17. See, e.g., Goodridge v. Harvey Group Inc., 728 F. Supp. 275, 285-86 (S.D.N.Y. 1990)(noting that the unconditional nature of the guaranty barred defense that the guaranty was fraudulently induced); see also Citizens Fidelity Bank & Trust Co. v. Coulston Int'l Corp., 553 N.Y.S.2d 901, 902 (N.Y. App. Div. 1990)(holding that a guarantor may not vary terms of an unconditional guaranty based on oral understanding); Scarsdale Nat'l Bank & Trust Co. v. S.E.W. Prods., Inc., 542 N.Y.S.2d 717 (N.Y. App. Div. 1989)(explaining that where the document expressly and unambiguously states that the guaranty is unconditional and contains no limitation, the guarantor may not claim that the guaranty was intended to be limited in applicability).

18. The distinction between a surety and guarantor is that the surety is a party to the same instrument as the debtor. Thus, the surety is deemed to have knowledge of every default. A guarantor is not a party to the same instrument, but enters into a separate contract. Thus, a guarantor is only secondarily liable on the default of the debtor if he has notice of such default, unless notice is waived.

19. See Fehr Bros. v. Scheinman, 509 N.Y.S.2d 304 (N.Y. App. Div. 1986). The purpose of characterizing the guarantor as primary obligor is to evidence the guarantor's absolute obligation to satisfy the borrower's obligations to the bank upon the borrower's default.


21. Under English law, if the guarantor enters into a guaranty conditioned on the lender's promise to advance funds to a borrower, the guaranty is deemed a bilateral agreement binding upon the guarantor at the advancement of funds to the debtor, and the obligation may not be revoked. 2 Joseph Chitty, Chitty on Contracts ¶ 5018, at 1347 (26th ed. 1989). For example, a guaranty of a fixed loan amount advanced with a definite repayment date may not be revoked by the guarantor until such date of maturity, since consideration for the guaranty may be deemed entire and indivisible. 2 id. at 1348.
In addition, characterizing a guaranty as "irrevocable" has significance when coupled with the expression that the guaranty is a "continuing" obligation. As discussed in the next section, under the laws of England and the State of New York a "continuing" guaranty obligates the guarantor to repay present and future advances actually made to a borrower. A guarantor may not revoke its guaranty for any further amount of funds actually lent by the lender. For instance, under a revolving credit facility on which the borrower has defaulted, the guarantor is liable for the remaining debt regardless of whether the original sum advanced has been repaid.

Even when a guaranty provides that it is continuing and irrevocable, a guarantor may revoke its guaranty as to future advances not yet lent. Moreover, this right of revocation is generally not waivable. At any time, a guarantor may revoke its obligation with respect to future advances and limit its liability to the amounts outstanding under the loan agreement at that time. In contrast to obligations presently incurred, under the law of England and in most U.S. states a guarantor would generally have to specify what conditions would give it the right to revoke its guaranty. Given the difficulty of anticipating all the circumstances in which a guarantor might allege revocation of the guaranty, the lender should specify that the guaranty is irrevocable.

But it is common practice to require a specified period of notice to be given before a guaranty can be revoked and this is thought to be binding of the surety. If the guaranty is treated as a standing offer, it is uncertain whether the surety would be liable for advances made by the creditor after receipt of notice of termination of the guarantee, but before its expiry.

Note, however, that under New York law, a guaranty that provides for written termination cannot be discharged or changed orally. N.Y. GEN. OBLIG. LAW § 15-301 (McKinney 1989); see also Bankers Trust Hudson Valley, N.A. v. Christie, 420 N.Y.S.2d 521, 522 (N.Y. App. Div. 1979)(Staley, J., dissenting). It may be prudent to provide in the guaranty that only written revocation delivered to the lender is valid revocation.

22. 2 id. "Where the guaranty is a continuing one, the question whether it can be revoked after the consideration has been partly performed depends on whether the consideration is divisible or entire." 2 id. In a continuing guaranty, the advancement of funds to the debtor and acceptance by the debtor constitutes part performance of the consideration. With respect to future advances consideration fails, and the guaranty is revocable with respect to such advances. 2 id.

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23. 2 id.; see also Chemical Bank v. Sepler, 457 N.E.2d 714, 716 (N.Y. 1983).

24. This is true in both England and the United States. See 2 CHITTY, supra note 21, ¶ 5018, at 1348; 1 RUDA, supra note 8, § 11.04[4], at 11-15.

25. Note, however, that under New York law, a guaranty that provides for written termination cannot be discharged or changed orally. N.Y. GEN. OBLIG. LAW § 15-301 (McKinney 1989); see also Bankers Trust Hudson Valley, N.A. v. Christie, 420 N.Y.S.2d 521, 522 (N.Y. App. Div. 1979)(Staley, J., dissenting). It may be prudent to provide in the guaranty that only written revocation delivered to the lender is valid revocation.

26. See 2 CHITTY, supra note 21, ¶ 5018, at 1348. In England, for instance, death or insanity of the guarantor will not cause the revocation of an otherwise irrevocable guaranty. 2 id. If the guaranty provides for revocation upon the death of the guarantor, notice of the death must be given by the guarantor's executor in order for the guaranty to be revoked. 2 id.; see also National Westminster Bank v. Bronstein, 558 N.Y.S.2d 33 (N.Y. App. Div. 1990)(explaining that a guaranty that could terminate only upon written notice delivered to lender and duly receipted was valid).

27. The express provision of irrevocability waives certain defenses that may be raised by a guarantor. Express irrevocability in a guaranty, however, does not mean that a guarantor must proceed to complete the performance of the borrower's obligations at risk to itself beyond that of the borrower.
3. Continuing Guaranty

A “continuing” guaranty is a misnomer. It does not mean that the liability of the guarantor endures forever. Unlike a restricted guaranty that expires upon payment or performance, a continuing guaranty binds a guarantor for the obligations of a debtor on an ongoing basis, regardless of whether the initial transaction that gave rise to the guaranty is completed. The term is generally employed in a revolving loan transaction that permits a debtor to continually draw down and repay funds from a lender on an arranged amount of credit. The “continuing” nature of the guaranty prevents the guarantor from asserting that the guaranty expired upon payment in full by the borrower of a previous drawing on the loan facility. A continuing guaranty, therefore, anticipates a relationship between a lender and a borrower based on a series of successive transactions as opposed to a restricted guaranty that is intended to cover a limited number of transactions.

However, absent an explicit characterization as “continuing,” it can be difficult to ascertain whether a guaranty is continuing or restricted. A lender is exposing itself to considerable danger if the guaranty does not provide for its continuing intent. Under neither English nor U.S. law are there established rules of construction that will guide courts. For example, in England, a guaranty which covered “further advances” was held not to be a continuing guaranty, while in New York, a guaranty for “any and all present and future advances” was found to be continuing.

If not characterized as a continuing obligation, a guaranty may be considered extinguished when the borrower repays its current outstanding balance under the credit agreement. Consequently, a guarantor could

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28. WOOD, supra note 20, § 13.3(3). Under English case law the term “continuing” is not required, and the intent of the term can be captured by more precise language. But since the term is standard guaranty nomenclature, it is prudent to include it in the guaranty.

A non-continuing guaranty is usually called a restricted guaranty. Such a guaranty is typically enforceable only for a particular transaction.

A guaranty expressly stating that it is a continuing guaranty and that the guarantor guarantees prompt payment on existing debts or those hereafter incurred is, manifestly, a continuing guaranty. 63 N.Y. JUR. 2d Guaranty & Suretyship § 86 (1990)(citing Franklin Nat'l Bank v. Skeist, 373 N.Y.S.2d 869 (N.Y. App. Div. 1975)). Cf. Sepler, 457 N.E.2d at 716 (explaining that a guaranty for “any and all present and future debts” is a continuing guaranty).


30. This is true under English law and U.S. law. See 2 CHITTY, supra note 21, ¶ 5040, at 1363; 1 RUDA, supra note 8, § 11.03[5].

31. 2 CHITTY, supra note 21, ¶ 5040, at 1363.

32. 2 id.

33. 2 id.

34. 2 id.

35. 2 id. at 1364 (citing Burnes v. Trade Credits Ltd. [1981] 1 W.L.R. 805 (P.C.)(appeal taken from N.S.W.)). In Burnes, the guaranty was found not to cover a new loan with an enhanced rate of interest, and no money was advanced. 2 id.


conceivably be held not liable for a subsequent advance under a facility agreement after the initial loan had been repaid in full.  

B. Consideration

A guaranty, like any contract, must be supported by consideration in order to create a binding and enforceable agreement. Questions of consideration in this context generally address whether value has been given by the secured lender in return for the guarantor's entering into the guaranty, and whether the guarantor derived some benefit from assuming its obligation under the guaranty. Under both English and U.S. law, it is generally established that where the secured lender provides a loan to a borrower in reliance on the execution of a guaranty to secure the borrower's obligation to the lender, the consideration under the loan agreement supports the consideration under the guaranty.

If the guaranty is made after the loan agreement is signed or after money is advanced, it becomes more likely that the guaranty will have to be supported by independent consideration in order to be enforceable. The causal

Div. 1990)(holding that a guaranty providing for “any and all debt” was sufficient to bind guarantor where creditor extended additional funds to debtor unbeknownst to guarantor and guarantor alleged guaranty was breached).


39. See European Am. Bank & Trust Co. v. Boyd, 516 N.Y.S.2d 714, 715 (N.Y. App. Div. 1987)(for a guaranty to be binding there must be consideration at or about the time of execution); 2 CHITY, supra note 21, ¶ 5018, at 1347; 1 RUDA, supra note 8, § 11.04[3].

40. 1 RUDA, supra note 8, § 11.04[3].

41. See Halpern v. Rosenbloom, 459 F. Supp. 1346 (D.C.N.Y. 1978)(finding a guaranty to be valid when it contemplated accrual of future indebtedness); Morley v. Boothby, 130 Eng. Rep. 455 (K.B. 1825). This generally assumes that the loan agreement or commitment was entered into contemporaneously with the guaranty. In reality the loan agreement and the guaranty need only be executed within a close period of time. See Boyd, 516 N.Y.S.2d at 715. Forbearance from undertaking some action, in addition, generally provides sufficient consideration. 38 AM. JUR. 2D Guaranty § 43 (1968)(citing Moore Lumber Corp. v. Walker, 67 S.E. 374 (Va. 1910)). If a guaranty is given after the lender advances funds a court may require that there be independent consideration. See 1 RUDA, supra note 8, § 11.04[3]. “The absence of such independent consideration is a conventional line of defense for a guarantor [in the United States].” 1 id.

42. 1 RUDA, supra note 8, § 11.04[3]; see also Bank of Montreal v. Sperling Hotel Co., 36 D.L.R.3d 130 (Man. Q.B. 1973)(finding no consideration for a guaranty made to secure further advances never made). Under English law, a guaranty made for past consideration is void. 2 CHITY, supra note 21, ¶ 5020, at 1349. However, under English law, consideration may be found for a past act if it is found that “the act is done at the guarantor’s request, that the parties understood that the act was to be remunerated in some way and that the conferment of a benefit would have been legally enforceable had it been promised in advance.” 2 id. at 1350. Moreover, consideration will be deemed present under English law for guaranty of an old debt if there is forbearance on the part of the lender. 2 id. ¶ 5021, at 1350. Forbearance (either by actual promise or upon request, implicit or otherwise) from suing, or an extension of time to, the borrower will suffice, if for a “reasonable time.” 2 id.

U.S. law is generally in accord with respect to resolving the problem of past consideration. See Robert M. Lloyd, Loan Guaranty Contracts: How to Make Them Enforceable, 107 BANKING L.J. 292, 294 (1990). Lloyd discusses “problem areas” with respect to sufficient or insufficient consideration. One common problem in international transactions is a “guaranty to shore up an
connection between the loan being made available in reliance upon the execution of a guaranty may be defeated because (1) the loan was made or the lender committed to make the loan prior to the guaranty being made, i.e., past consideration, or (2) the loan agreement and guaranty were not signed contemporaneously. The guarantor may argue that the loan was not made in reliance on the guaranty as security. The guarantor may also argue that the loan was made despite the absence of a guaranty. If no consideration is present, a guaranty under English law, unlike under U.S. law, may be put under seal in order to satisfy the requirements of consideration.

Consideration, however, is an amorphous concept and courts will often find consideration in unfathomable places. For example, apparent lack of consideration can typically be remedied by showing that the loan was made on the “promise” to guaranty the loan. Careful drafting can ensure that consideration is present. An appropriate wording of the consideration clause might be:

In consideration of the Lender continuing to make the loan available to the Borrower and other good and valuable consideration the receipt and adequacy of which the Guarantor hereby acknowledges . . .

The word “continuing” or, alternatively, the phrase “this guaranty is in consideration of the Creditor’s forbearance in pursuing default remedies against Borrower” is language intended to demonstrate the presence of consideration. It is prudent to use such language when the loan agreement and guaranty are not made contemporaneously or when monies are advanced prior to obtaining the guaranty.

C. Payments

The payment provision obligates the guarantor to make all payments owed to the lender without making deductions for any tax assessment, right

existing credit that has become shaky.” Id. at 296. To avoid the release of the guarantor, a suggested method is to modify the loan at the time the guaranty is entered into providing the borrower or guarantor with some value. Id. For example, “[a] waiver of an existing event of default is probably enough, so long as it is a waiver of a substantial default and is effective for a reasonable time.” Id.

43. For example, a guaranty may be given to shore up an existing credit. See Lloyd, supra note 42, at 296-97.

44. Id. at 296. Such an argument on the part of a guarantor was defeated in Halpern, 459 F. Supp. at 1346, where value moving from the creditor to the principal was held to constitute valid consideration for a guaranty of debts both future and past.


48. Under English law it may also be prudent to have the guaranty sealed. See 2 CHITTY, supra note 21, ¶ 5020, at 1349.
of set-off the guarantor may have, or any other claim or right that may decrease the amount the guarantor must pay in order to make the lender whole. Payment is usually triggered by the debtor’s default under the loan agreement, without the necessity of demand on the part of the lender. The guaranty generally provides for payment of the entire obligation of the debtor that is outstanding. In an international transaction, a question may arise as to the currency in which the guarantor is obligated to pay. Failure to specify a currency may cause the lender to incur a significant loss.

However, a lender may receive payment in an undesignated currency despite an explicit designation of currency. Therefore, a guaranty should include a multi-currency clause in order to reduce the likelihood of the lender receiving less than it should as a result of payment in a foreign currency under unfavorable exchange rates. Lastly, a lender should consider the inclusion of a tax indemnification clause in its guaranty.

1. Payment Provision

A payment clause in a guaranty should provide that all payments are to be made in the designated currency in full without any set-off or counterclaim whatsoever and free of any deductions or withholdings. Designating the currency of payment removes any ambiguity in the choice of currency that the lender expects to receive in payment and avoids problems of convertibility.

What may happen if no such designation is made? In all likelihood, the law governing the guaranty will be applied to determine in which currency the lender should receive payment. In England, if no currency is specified it is presumed that the chosen currency is the one with which the underlying contract is most closely associated. Some other jurisdictions permit a foreign currency obligation to be repaid in the currency of the local jurisdiction. In such a case, a lender could suffer an unexpected loss if an

49. But see Holl v. Hadley, 111 Eng. Rep. 292 (K.B. 1835)(holding a creditor to be barred by statute of limitations after allowing two years to lapse before seeking to enforce guaranty).

50. Upon default, a guaranty generally provides that the guarantor is obligated for the entire amount of the accelerated debt. Otherwise the guarantor may argue it is only responsible for that installment of the loan defaulted on. This may leave the lender in the position of suing on each installment.

51. Payment in full should also include attorney’s fees. A provision for reimbursement of expenses incurred, however, was ruled not to include attorney’s fees that accrued in the course of a seven-year lawsuit to enforce the guaranty. In re Rubin Bros. Footwear, 119 B.R. 416, 426 (Bankr. S.D.N.Y. 1990).

52. See generally WOOD, supra note 20, § 2.6(2). Most courts will render judgments in the currency of their home country. In the United States the term “payable” generally is sufficient to provide that the guarantor has no option to pay in any currency other than that specified. The parties may be free to fix the conversion rate at the date closest to the date of conversion by the court.

53. Id. (citing Bonython v. Australia, 1951 App. Cas. 201 (P.C. 1950)(appeal taken from Austl.)).

54. Id. § 2.6(5), at 53. The parties are free to designate any currency of payment, usually in some form of legal tender. However, some “currency” is not useable. A gold clause, for exam-
unfavorable rate of exchange were applied.\textsuperscript{55} The lender may wish to avoid the unpredictability of documenting payments in multiple currencies and a possible loss attributable to fluctuating rates of currency.\textsuperscript{56}

Without a payment provision, a guarantor's allegation of a right of "set-off" could reduce the amount payable to the lender. A set-off right allows a guarantor to reduce its obligation by the amount of some claim against the debtor or some claim against the funds it is obligated to pay the lender. To prevent this result, a lender should require a guarantor to waive its right of set-off, along with any related claims it may assert. A lender cannot afford to acknowledge a guarantor's argument for a set-off claim, regardless of the merits. After all, a guarantor may not give the lender the money it receives from the debtor.

Another potential loss to the lender may arise in connection with local currency provisions or in the imposition of local withholding taxes.\textsuperscript{57} In an international lending transaction, the payment provision in a guaranty may help the lender receive the entire amount of its outstanding loan.

2. \textit{Multi-Currency Provision}

A multi-currency clause is a provision that attempts to prevent loss to a lender caused by a payment in a different currency from that originally lent or required to be paid by the borrower.\textsuperscript{58} If monies are accepted in an undesignated currency, the actual value of the funds received by a lender will vary depending on the conversion rate for such funds on a specified date.

Payment in a different currency may arise in various circumstances, the most common being that the guarantor simply wishes to pay in the different currency. Payment in an undesignated currency, unless otherwise bargained for, should be expressly disallowed in the guaranty. If payment is received in a different currency and accepted by the lender, the guarantor should be expressly required to indemnify the lender against any loss attributable to converting such monies into the loaned currency.

\textsuperscript{55} Wood, supra note 20, \S 2.6(5), at 53-54 ("if a foreign currency debt is payable in England under a contract governed by English law it can be paid either in foreign currency or in sterling at the rate of exchange at which on the day the debt is payable that foreign currency can be converted into sterling on a recognized and accessible market, irrespective of any official rate of exchange") (paraphrasing Marrache v. Ashton, 1943 App. Cas. 311 (P.C.) (appeal taken from Gib.)).

\textsuperscript{56} If no governing law provision exists in the guaranty, the lender is exposed to even more risks and unpredictability. For a discussion of choice of law, see supra part II.F.

\textsuperscript{57} See Francis D. Logan & Peter D. Rowntree, Term Loan Agreements, in \textit{1 International Financial Law} \S 2.4, at 6 (2d ed. 1985).

\textsuperscript{58} In the United States some contractual currency obligations may be unenforceable. A U.S. bond subject to U.S. law that specified payment in multiple currencies at stated rates of exchange was held to be payable only in U.S. currency. Guaranty Trust Co. v. Henwood, 307 U.S. 247 (1939).
Payment may also arise in a contrary currency as a result of an action commenced against the guarantor for breach of its obligations under the guaranty. A judgment rendered by a foreign court in a foreign currency, or an enforcement of a foreign judgment resulting in payment in the local currency, may occur without giving effect to the bargained-for choice of currency, conversion date, or conversion rate.\(^59\)

A lender can lose money if a court enters a judgment on a date when there is a certain exchange rate and subsequently the lender receives the judgment funds on a date when the rate has changed unfavorably. The question then arises as to when the conversion rate is fixed by the court for determining the judgment amount. Is it the day judgment is entered, the date when the underlying obligation matured, or the date the agreement was breached? Naturally, the lender will seek to be protected from any loss arising in connection with a foreign judgment.

In the United States, courts generally apply the "judgment day rule" for conversion of debts incurred out of the country.\(^60\) A U.S. court would be likely to choose the date of judgment as the date of conversion for ascertaining the amount of the award to the lender.\(^61\) An English court would also...

\(^59\). 54 AM. JUR. 2d Money § 31 (1971). In New York, for example, the courts have no power to award a judgment in a foreign currency. See Teca-Print A.G. v. Amacoil Mach., Inc., 525 N.Y.S.2d 553 (N.Y. Sup. Ct. 1988). This is the general rule in the United States. Thus, an agreement expressed in terms of a foreign currency must be converted by U.S. courts into U.S. currency to enable the court to make an award. 54 AM. JUR. 2d, Money § 31 (1971). However, a debtor will only be deemed to have fully paid its debt if the creditor has received the amount of the debt. See Feldman v. New York City Health & Hosp. Corp., 445 N.Y.S.2d 535, 559 (N.Y. App. Div. 1981), rev'd, 439 N.E.2d 398 (N.Y. 1982). See supra part II.F for a discussion on choice of law and forum.

\(^60\). In New York and many other U.S. states, recognition of foreign judgments is covered by statute. See Uniform Foreign Money-Judgments Recognition Act, N.Y. CIV. PRAC. L. & R. 5303 (McKinney 1978). In New York, such foreign judgments are enforceable under this Act by an action on the judgment, a motion for summary judgment in lieu of complaint, or in a pending action by counter-claim or affirmative defense. This Act does not, however, limit the types of actions or law recognized in New York.

Absent a showing of fraud in the procurement of the foreign judgment or a showing that recognition of the judgment would do violence to some strong public policy of the state, New York law extends comity to uphold the validity of foreign judgments. See Greschler v. Greschler, 414 N.E.2d 694 (N.Y. 1980).

\(^61\). See Zimmerman v. Sutherland, 274 U.S. 253 (1927); Deutsche Bank Filiale Nurnberg v. Humphrey, 272 U.S. 517 (1926). This is true if the payment of the foreign currency is made in the foreign country and the lender obtains a judgment in such country. The U.S. court will value the currency on the date of judgment. The rationale of the rule is to prevent "abuse in a situation where a claimant could gain by bringing suit" on a foreign claim. Banco Nacional de Cuba v. Chase Manhattan Bank, 505 F. Supp. 412, 464, modified, 514 F. Supp. 5 (S.D.N.Y. 1981), and modified, 658 F.2d 875, rev'd sub nom. Banco para el Comercio Exterior de Cuba v. First Nat'l City Bank, 658 F.2d 913 (2d Cir. 1981), rev'd, 462 U.S. 66 (1983). Conversion on the day of judgment was to result in an amount "equal to that which would have been obtained in the foreign jurisdiction on the same date." Id.

However, if the foreign currency is to be paid in the United States, the guaranty may be deemed to be performed in the United States and the conversion date will be the date of breach. See 54 AM. JUR. 2d Money § 31 (1971).
reference the judgment date as the conversion date. The rules defining the date of conversion, however, do not override a prior determination as to the applicable rate of conversion from, for example, a foreign currency to U.S. dollars. In the United States, courts will entertain the parties’ prerogative. The parties to the guaranty are free to fix a conversion rate in the agreement. The parties could agree in the document what the rate of conversion shall be or what particular date of exchange shall apply.

In addition, the guaranty should provide that the guarantor pay any loss to the lender caused by a difference in the rate chosen by the court and the rate existing on the date of payment. A sample provision of such an indemnity clause may provide:

If any sum due from the Guarantor under this Guaranty or any order or judgment given or made in relation to this Guaranty has to be converted from the currency into another currency for the purpose of: (a) making or filing a claim or proof against the Guarantor; (b) obtaining an order or judgment in any court or other tribunal; or (c) enforcing any order or judgment given or made in relation to this Guaranty, the Guarantor shall indemnify and hold harmless each of the persons to whom that sum is due from and against any loss suffered as a result of any discrepancy between (i) the rate of exchange used for such purpose to convert the sum in question from the currency into the other currency and (ii) the rate or rates of exchange at which such person may, in the ordinary course of business, purchase the currency with the other currency on receipt of a sum paid to it in satisfaction, in whole or in part, of any such order, judgment, claim, or proof.

62. Wood, supra note 20, § 2.6(5), at 54.
65. If no actual expression of the rate exists in the agreement, the plaintiff has the burden of establishing the rate. In a “default date” judgment, the U.S. court may be able to choose amongst available rates. See 54 Am. Jur. 2d Money § 32 (1971). If several rates are applicable, the money market rate would apply over the official rate (i.e., the “free market” rate). In a “judgment date” application, a U.S. court may apply the official rate since the lender will then receive the proper amount on reconverting it into the foreign currency. Id.
66. With regard to choosing a date of exchange in a guaranty, one author has suggested that referencing the date to a date prior to that of the judgment would function to provide a rate of exchange closest to that of the date of judgment. Wood, supra note 20, § 2.6(6), at 54-55. This would be the closest date prior to the lender actually receiving funds under the guaranty. Id. at 55.
67. Id. at 55. The clause also should provide that the liability of the guarantor for any shortfall in the judgment amount and the amount necessary to make the lender whole constitutes an independent obligation from the guarantor’s other obligations and shall give rise to an independent cause of action. Id. This provision defeats a guarantor’s defense that a claim merges in a judgment.
68. Whether the multi-currency provisions or indemnity provisions will be effective in a court of foreign jurisdiction where enforcement is sought may depend on the court’s willingness to submit its jurisdiction to a finding of another jurisdiction, the choice of law provisions in the guaranty and their validity, and treaty provisions of reciprocal enforcement. For a discussion of enforcement see supra part II.F.
Any loss related to the conversion rate with respect to the total sum due under the loan agreement is to be made up by additional payments to the lender to insure it is made whole.

3. Indemnity Provision

In addition to any deficiency in the sum due the lender that is attributable to any right of set-off or conversion of currency, a lender will usually insist on being protected from any tax or withholding arising in any jurisdiction that may be assessed in connection with the loan transaction. This protection usually takes the form of a provision indemnifying the lender against any reduction in the amounts it receives from the guarantor in satisfaction of the debtor's obligation caused by charges, assessments, or taxes on the guarantor's payments.

The imposition of a withholding tax on the amounts paid by the guarantor is typically the loss that most concerns a lender. A withholding tax is

69. There are other causes of loss against which a lender may also seek indemnity from a guarantor. In the event of non-payment, the lender may wish the guarantor to indemnify it for losses due to the missed payment, e.g., having to "liquidate deposit contracts or to re-employ funds acquired for purposes of making loans." See Logan & Rowntree, supra note 57, at 9.

The indemnification provision in the context of payment usually centers on any reduction attributable to a tax. The lender may also wish to be indemnified against any loss arising by breach of the guaranty agreement by the guarantor or loss attributable to non-performance.

70. It may be helpful to distinguish between a guaranty and an indemnity. Under both English and U.S. law the difference between the two agreements is that a guarantor obligates itself to be secondarily responsible for a borrower's debt. In a contract of indemnification the indemnifier assumes a primary liability. See 2 CHITTY, supra note 21, ¶ 5016, at 1345. At first blush, this distinction does not appear to be great, since the purpose of the guaranty of payment is to hold the guarantor liable as a primary obligor. However, a guarantor, unlike an indemnitor, is usually released from its obligations once the liability of the debtor is extinguished. 2 id. In England under section 4 of the Statute of Frauds of 1677, a guaranty must be in writing to be enforceable, while no such statutory requirement exists for a contract of indemnity. 2 id. (citing the Statute of Frauds, 29 Car. 2, ch. 3, § 4 (1677)(Eng.)).

71. The rationale for the indemnification provision is that if a government requires that payments be made to a lender less a certain taxed amount, the agreement negotiated between the lender and the guarantor cannot override the law. WOOD, supra note 20, § 12.5(3).

72. In a lending transaction a lender will usually seek to shift to the borrower not only responsibility for paying taxes imposed by its jurisdiction but also any tax imposed by a jurisdiction other than its own. See Logan & Rowntree, supra note 57, § 2.4, at 6; see generally WOOD, supra note 20, § 12.5(4). Usually, this is simply a function of business. The lender needs to be assured of a return on its money. Depending on the parties' negotiating strength, however, the guarantor may be able to negotiate who should bear the economic burden of a withholding tax. See Logan & Rowntree, supra note 57, § 2.4, at 6.

This involves an investigation of the borrower's jurisdiction to determine if a tax exists, on which party it is imposed, the liabilities applicable to the parties, and whether such liabilities can be shifted under the law to a particular party. Id. Some countries expressly prohibit allocation of the tax to the local borrower or penalize such allocation. Id. An investigation of such tax liabilities would be prudent. Id. As discussed infra part II.c, an examination of any tax treaties or laws limiting double taxation must also be considered.

Increasingly, sophisticated guarantors are seeking to shift some tax burden to the lender. See Logan & Rowntree, supra note 57, § 2.4, at 6. Tax benefits under the laws of the lender's home country are also being shared with the guarantor.

Other taxes that may concern the lender are stamp or documentary taxes due in connection with the signing of the guaranty or the transaction. Typically, such stamp duties are small. In
an amount deducted from the payment by the government where the borrower resides. Generally, a withholding tax taxes interest payments of the borrower/guarantor. In effect, the government is taxing the lender's income that originates from the borrower situated in and subject to its jurisdiction.

Section 1442 of the U.S. Internal Revenue Code of 1986, as amended (the "Tax Code"), provides for the withholding tax on foreign corporations. Section 881 of the Tax Code provides for the tax on income of foreign corporations. Under these sections, interest payments made by a U.S. company to a foreign banking corporation are subject to a thirty-percent withholding tax. This rather severe tax is avoided by a tax treaty between the United States and England. Under this treaty, the withholding tax required by U.S. law is inapplicable to an English resident. A U.S. resident operating in England would likewise be exempt from the English withholding tax.

However, because of the changing nature of tax laws and judicial rulings, an indemnification provision is usually broadened to capture all conceivable

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73. Under U.S. and English law, certain income may only be taxed in the taxpayer's country of residence. See infra note 80.

74. Wood, supra note 20, § 12.2(1), at 282. The reason for imposing this tax is that it is the "only effective method of collecting tax from non-residents since foreign courts will not usually enforce the tax laws of other countries by allowing a state to sue directly in foreign courts for taxes due." Id.


76. I.R.C. § 881.

77. See id. § 1442; see also id. § 881(a)(1), which reads:

(a) Imposition of tax. Except as provided in subsection (c), there is hereby imposed for each taxable year a tax of 30 percent of the amount received from sources within the United States by a foreign corporation as

(1) interest (other than original issue discount as defined in section 1273), dividends, rents, salaries, wages, premiums, annuities, compensations, remunerations, emoluments, and other fixed or determinable annual or periodical gains, profits, and income.


Article 11(1) of the Convention states that interest derived and beneficially owned by a resident of the United Kingdom shall be exempt from tax by the United States. Id. art. 11(1). The converse is also true: a U.S. resident is not subject to U.K. withholding tax. "Interest" is defined under Article 11(3) as "income assimilated to income from money lent." Id. art. 11(3).

Under Article 10 of the Convention, the 30% U.S. withholding tax that applies to dividends paid by a corporation organized in the United States to a foreign corporation is reduced, but not abrogated, by the Convention, if the beneficial owner of the dividend is a U.K. resident: (i) to 5% where the dividend is paid to a U.K. resident corporation which controls at least 10% of the voting stock of the U.S. corporation paying the dividend; or (ii) to 15% for all others. Id. art. 10.

79. Most jurisdictions permit a variety of exemptions that allow financing transactions to proceed without the imposition of withholding taxes. See Wood, supra note 20, § 12.2(1), at 282. In practice, interpretive situations arise where a transaction is not structured as to fall easily within the requirements of the exemption.
taxes that may be imposed by a taxing authority of a particular government.\textsuperscript{80} One expansive form is as follows:

Should the Guarantor be compelled by law, regulation, decree, order, or stipulation to make any deduction or withholding on account of any present or future taxes (including, without limitation, property, sales, use, consumption, franchise, capital, occupational, license, value added, excise, stamp, levies and imposts taxes, and customs and other duties), assessments, fees (including, without limitation, documentation, license, filing, and registration fees), deductions, withholdings, and charges, of any kind or nature whatsoever, together with any penalties, fines, additions to tax or interest thereon, however imposed, withheld, levied, or assessed by any country or governmental subdivision thereof or therein, any international authority or any other taxing authority ("Taxes") from any payment due under this Guaranty for the account of the Lender, the sum due from the Guarantor in respect of such payment shall be increased by such additional amounts necessary to ensure that, after the making of such deduction or withholding with respect to Taxes, the Lender receives a net sum equal to the sum which it would have received had no such deduction or withholding with respect to Taxes been made, and the Guarantor shall indemnify the Lender against any losses or costs incurred by reason of any failure of the Guarantor to make any such deduction or withholding or by reason of any such additional payment not being made to the Lender on the due date for such payment. The Guarantor will deliver to the Lender evidence satisfactory to the Lender including all relevant tax receipts that such Tax has been duly remitted to the appropriate authority.

Tax indemnification provisions can be intricate.\textsuperscript{81} Special attention should be given to drafting such provisions, especially in international loan transactions.\textsuperscript{82}

\textsuperscript{80} Such a provision should also take into account the existence of a double taxation treaty, like the U.K.-U.S. treaty discussed supra note 78. Most jurisdictions are parties to this type of tax treaty. In essence, the treaty is designed to prevent double taxation by each of the countries having jurisdiction over the parties to the financing transaction. \textit{Id.} \S 12.2(2), at 283.

\textsuperscript{81} For example, the guarantor may request an additional provision that if the lender is provided a credit after the guarantor has grossed-up the lender, i.e., included the amount deducted in withholding tax in its payment, the guarantor be reimbursed in the amount of the credit. The following is an example of this kind of provision:

If Taxes are required to be deducted or withheld by the Guarantor for any payment made pursuant to this agreement to the Lender that results in the Guarantor paying additional amounts to the Lender, and the Lender claims a credit for such Taxes against any other Taxes payable by it, then the Lender shall pay to the Guarantor an amount equal to the amount of such credit.

Alternatively, the guarantor may require the lender to provide or file any forms, statements, or certificates necessary for the lender or guarantor to be exempt from tax or to receive a reduced rate.

\textsuperscript{82} See \textsc{Wood}, supra note 20, \S 12.5(3). An alternative to the tax indemnification is the "gross-up" provision. See \textit{id.} \S 12.5(2). A gross-up provision provides that the guarantor will pay the lender the amounts deducted in withholding tax with its payment. \textit{Id.} The difference between a gross-up provision and an indemnification provision is complicated and involves the tax credit system. See \textit{id.} \S 12.5(3).

The tax credit system is designed to give relief to lenders. \textit{Id.} \S 12.5(5). It gives a credit for taxes paid in a foreign jurisdiction when the lender calculates its own tax liability. \textit{Id.} Wood usefully illustrates the difference between a tax indemnification and a gross-up provision:

[F]or example, if tax is required to be withheld at the rate of 25% and if those amounts must be grossed-up under the loan agreement the lender may be deemed
D. Subrogation

Subrogation is the substitution of one person for another who assumes the rights in any debt or claim of that other. In connection with a guaranty, this right of subrogation becomes problematic. Under this right, any time the guarantor performs under the guaranty, for example, by making a partial payment to the lender on the borrower's obligation, it has the right to supplant the lender and demand repayment from the borrower. The lender's collateral or security may then be at risk. It may be depleted or harmed through actions of the borrower, or through actions of the guarantor should it exercise its right of subrogation. Consequently, the lender should protect its interests in the collateral by preventing subrogation by the guarantor until the lender has been paid in full. Accordingly, a typical guaranty will provide:

Until all amounts due or that become due have been paid the Guarantor shall not stand in the place of the Lender in respect of any security or money and shall not take any step to enforce any right or claim whatsoever against the Borrower in respect to any monies paid by the Guarantor to the Lender under this guaranty.

Another typical formula provides:

Until all monies and obligations due and owed by the Borrower to the Lender under this guaranty have been paid or discharged in full, the Guarantor agrees not to exercise or enforce any of its rights of subrogation.

These provisions ensure that the guarantor agrees not to exercise its right of subrogation until the lender is made whole. In so doing, the guarantor has basically assumed the lender's risk for any non-payment or non-performance by the borrower. It has also forestalled its own rights against the borrower, thereby assuming the possible additional risk that the borrower's assets and resources may be depleted. Some lawyers representing lenders believe that certain guarantors should waive their subrogation rights.

If there is more than one guarantor, each should subordinate its rights against the debtor to the rights of the lender. In addition, the guaranty

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Id. § 12.5(3).

83. See In re Steve's Furniture Warehouse, Inc., 46 B.R. 80, 82 (Bankr. 1985) (guarantor is subrogated to lessor's rights against lessee to extent of payments). Once a guarantor has a right of subrogation for partial payments owed the creditor, the guarantor can proceed against the debtor and its assets to the fullest extent to recover on its partial payments to the creditor.


85. Forestalling its right of subrogation ensures, in addition, that the guarantor will take an active interest in the borrower's business activities and will urge that those activities be conducted effectively. Naturally, the lender will take an active interest in the guarantor's financial strength as well as its relationship vis-a-vis the borrower. See William Barnett, Limited Guarantees: Variations, Limitations, and Lamentations, 104 BANKING L.J. 244, 245-46 (1987).
should expressly state that the obligations of co-guarantors are joint and several.\textsuperscript{86} Under U.S. law, the absence of such language permits the guarantors to claim that their liability is only jointly shared. A finding of joint liability, rather than joint and several liability, may limit the lender's ability to collect from an individual guarantor the entire amount due under the loan agreement and related security documents. The lender may be required to proceed separately against each guarantor, reducing the lender's ability to quickly recover its funds from a defaulting debtor.\textsuperscript{87}

\textbf{E. Waivers}

While subrogation postpones a guarantor's right, the law of waivers extinguishes a right altogether. A lender will generally require a guarantor to waive certain rights. Common law courts have ruled consistently that a variation or change in the terms of the underlying loan agreement without the guarantor's consent,\textsuperscript{88} or a sufficient change in circumstances,\textsuperscript{89} justifies the release of the guarantor from its obligations.\textsuperscript{90} In Canada, for example, it was held that a material variation of the terms of the principal contract discharged the guarantor of its obligations.\textsuperscript{91} The court reasoned that a change in the loan entitled the guarantor to be released, since it had not entered the original guaranty in consideration for, or on condition of, the new terms. Consequently, the guarantor was not bound by the new terms. A lender can

\textsuperscript{86} See 1 RUDA, supra note 8, § 11.06[4], at 11-25.

\textsuperscript{87} The guarantor may argue that it is unfair to require it to pay a disproportionate share of the borrower's obligation. Lender's counsel may counter that the guarantors may protect themselves by either (1) entering into an agreement of contribution among themselves or (2) allowing common-law principles of contribution to resolve any disputed disproportionate payment. Contribution requires persons to bear a ratable proportion of the amount for which they are liable.

\textsuperscript{88} Under English and U.S. law a guarantor that is properly and adequately informed and consents to a variation will remain bound. See 2 CHITTY, supra note 21, ¶ 5057, at 1377; see also Chemical Bank v. Geller, 727 F.2d 61 (2d Cir. 1984)(holding that the guarantor waived its right to assert defense by execution of guaranty explicitly setting forth such waiver). Moreover, a guarantor is not released even if the guarantor's consent is not sought for an extension of time by a lender, if the debtor is notified when the extension of time is given. See 2 CHITTY, supra note 21, ¶ 5057, at 1377.

\textsuperscript{89} See generally 1 RUDA, supra note 8, §§ 11.06[1]-[5].

\textsuperscript{90} Under English law, a variation of the underlying obligation will release the guarantor. See 2 CHITTY, supra note 21, ¶ 5041, at 1364-65 (citing Ulster Bank Ltd. v. Lambe, 1966 N. Ir. 161 (Q.B. 1965)). For example, in England, a guaranty of a loan repayable in installments was held unenforceable because the whole of the debt could be accelerated upon one default in an installment payment. See 2 id., ¶ 5042, at 1365 (citing Clarke v. Green, 3 Ex. 617, 619 (1849) (Eng.); Pickles v. Thornton, 33 L.T.R. 658 (1875)(Eng. C.A.)). As noted infra part II.A, a guaranty should provide for guaranty of the whole debt as a result of acceleration of the debt or otherwise. For a fairly comprehensive list of guarantor defenses and waiver language, see generally 24 Defenses, supra note 47.

\textsuperscript{91} See Ford Motor Credit Co. v. Sorenson, 35 D.L.R.3d 253 (N.B. Sup. Ct. 1973); see also National Westminster Bank v. Riley, 1986 B.C.L.R. 268 (noting that a minor breach of the underlying contract was non-repudiatory and not sufficient to release the guarantor).
require a guarantor to waive such a right in advance and such waivers are generally considered enforceable.\textsuperscript{92}

A waiver provision is a lender’s paramount protective clause. It relieves the lender of certain risks that may accompany the administration of a loan, and curtails many of the claims a guarantor is likely to make in seeking to be discharged from its obligations.\textsuperscript{93} Some of the more common waiver provisions include waiver of: (1) any invalidity or unenforceability of the underlying obligation or any applicable law;\textsuperscript{94} (2) any defense applicable to the guarantor as primary obligor under the underlying loan agreement, including any renewal or variance in the agreement,\textsuperscript{95} or any discharge or defect thereunder;\textsuperscript{96} (3) any disability, incapacity or lack of corporate power or authority...
of the debtor;\(^97\) (4) any claim based on application of payments by the borrower or other guarantor on the debt;\(^98\) (5) any right on the part of the guarantor to reduce its liability as a result of any renewal, modification, release, waiver or abstention from perfection or enforcement of any obligation;\(^99\) (6) any extension of time of performance by the borrower or any guarantor;\(^100\) (7) any discharge of any obligation in any insolvency, bankruptcy, reorganization or other similar proceeding;\(^101\) (8) any release of any co-guarantor or reduction in such guarantor’s obligation; (9) any dissolution of the guarantor or change in its personnel or corporate structure;\(^102\) (10) any defense based on preference payments by the lender to the debtor in bankruptcy or as a settlement payment;\(^103\) (11) any benefit of any statute of limita-
tions;\textsuperscript{104} (12) any right to require the lender to proceed against the borrower, or proceed against or exhaust the security of the borrower;\textsuperscript{105} (13) any defense arising out of the borrower's exercise of or failure to exercise any right or remedy it may have under the security documents; (14) any defense that the sale of collateral was not commercially reasonable;\textsuperscript{106} and (15) all presentations, demands, protests, and notices.\textsuperscript{107}

It is difficult to draft a concise and brief waiver of defense provision in a guaranty. In the United States this difficulty is exacerbated because the drafter may have to consider the laws of various U.S. states whose laws may vary substantially.\textsuperscript{108} In most instances the operative language is situated throughout the guaranty wherever it best addresses the particular subject. In

\textsuperscript{104} See FDIC v. Frank L. Marino Corp., 425 N.Y.S.2d 34, 36 (N.Y. App. Div. 1980)(holding that a waiver limiting creditor's responsibility for collateral is enforceable, but complete waiver is not); Allied Bank v. Eshaghian, 700 F. Supp. 206, 207 (S.D.N.Y. 1988)(noting that where a guaranty provided lender could "sell, exchange, release, surrender, realize upon or deal with [the collateral] in any manner," the guarantor could not avoid payment by arguing debtor but not lender should be able to sell collateral).

\textsuperscript{105} See generally Depositors Trust Co. v. Hudson Gen. Corp., 485 F. Supp. 1355, 1361 (E.D.N.Y. 1980)(explaining that notice was required to be given by lender). Each guaranty should explicitly incorporate a waiver of notice. Generally, notice is required to the guarantor when the debt is incurred by the borrower, when the borrower defaults in its payments to the lender, and when any adverse matters arise that materially increase the guarantor's risk.

Waiver of these requirements is prudent to ensure that the guarantor is not inadvertently released. For example, notice of incurring debt may apply to any future advance. Notification of an advance could be forgotten. With respect to notice of default, the lender wants the right to proceed immediately against the guarantor without any delay caused by arguments as to the proper dispatch of notice or the adequacy of notice. Also, the Restatement of Security requires a creditor to notify the guarantor of any adverse change that may materially affect its risk. \textit{Restatement of Security} § 124 (1941). What constitutes an adverse change or an increase in material risk is debatable, but such uncertainty should not be allowed as a legal argument for the guarantor. In New York, other defenses may be subject to waiver; for example, fraud in the inducement and duress can be said to be waived by the absolute and unconditional nature of a guaranty. See Graubard Mollen Dannet & Horowitz v. Edelstein, 569 N.Y.S.2d 639, 640 (N.Y. App. Div. 1991). Actual fraud and duress are not defenses notwithstanding a waiver.

\textsuperscript{107} See, e.g., infra part III for a discussion of two recent and contrasting rulings regarding the validity of waiver by a guarantor of a commercially reasonable sale of collateral.
addition to the waiver provisions discussed above, the following provisions may be found useful:

The obligations of the guarantor under this agreement shall remain in full force and effect without reducing or impairing the Guarantor's liability by:

(a) any extension or indulgence in respect of the payment of any amount payable, or the performance of any covenant, agreement, term or condition, under any of the Security Documents; or

(b) any amendment or modification of, or addition or supplement to, or deletion from any of the terms of any of the Security Documents, or any other agreement which may be related to any of the Security Documents; or

(c) any compromise, waiver, release or consent, or other action or inaction in respect of any of the terms of any Security Document; or

(d) any exercise or non-exercise by the Lender of any right, power, privilege or remedy under or in respect of this agreement or any Security Document, or any waiver of any such right, power, privilege or remedy or of any default in respect of this agreement or any Security Document or any guaranty or other agreement executed pursuant hereto, or any receipt or enforcement of any security or any release of any security; or

(e) any bankruptcy, insolvency, reorganization, arrangement, adjustment, composition, dissolution, liquidation, or the like, of the Lender, the Borrower or the Guarantor;¹⁰⁹ or

(f) any limitation of the liability set forth in any Security Document which may now or hereafter be imposed by any statute, regulation or rule of law, or any invalidity or unenforceability, in whole or in part, of such Security Document; or

(g) any merger or consolidation of the Borrower into or with any other person or entity, or any sale, lease or transfer of any or all of the assets of the Borrower to any other person or entity; or

(h) any indebtedness or other obligation of the Borrower to any person or entity, including the Guarantor; or

(i) any change in law;¹¹⁰ or

(j) any sale, transfer or other disposition by the borrower of any right, title to or interest in any of the Security Documents or the Collateral; or

¹⁰⁹. Under the United States Bankruptcy Code, a transfer shall not be deemed an avoidable preference if (1) made in payment of a debt incurred by the debtor in the ordinary course of business of the debtor; (2) made in the ordinary course of business of the debtor; and (3) made according to ordinary business terms. It is a factual test considering the totality of circumstances present. 11 U.S.C. § 547(e)(2) (1988). In England, Section 281(7) of the Insolvency Act 1986 provides that a discharge in bankruptcy does not release the guarantor. Insolvency Act, 1986, ch. 45, § 281(7) (Eng.). The guarantor will not be liable for the debtor's interest payments accruing after bankruptcy. See 2 CHITTY, supra note 21, ¶ 5048, at 1370. Other concerns exist when dealing with bankruptcy in the United States. In New York, a mortgagee has an “election of remedies.” It may pursue legal action or foreclose on property. Manufacturers Hanover Trust Co. v. 400 Garden City Assocs., 568 N.Y.S.2d 505, 507 (N.Y. Sup. Ct. 1991). A mortgagee that commences a foreclosure action against a guarantor can not commence a separate legal action, except in special circumstances. Id.

¹¹⁰. In an international transaction, this simple clause is crucial. Such a provision may account for several pages of the loan agreement. Great care should be taken to negotiate which party shall bear the burden of any change in the law, especially in transactions that are tax driven (such as those involving leveraged lease financing).
(k) absence of any notice to, or knowledge by, the guarantor of the existence or occurrence of any of the matters or events set forth in the foregoing subdivisions (a) through (j).

In addition, the guaranty often contains a "catch-all" provision or "draftsman's crutch" to capture any event or action that may act to release the guarantor from its obligations.

F. Choice of Law/Conflict of Laws

The final concept discussed in this article is the choice of law provision. Although it is often ignored, it is the heart and soul of a guaranty. Legal precedent guides the drafter of a guaranty, and choice of law determines the applicable legal precedent.

A choice of law provision is often critical to the validity and ultimate enforceability of a guaranty and its terms. With regard to this clause, the lender is generally concerned with two issues. The first involves the choice of law to govern the guaranty. The second is the submission, either exclusive or nonexclusive, to a particular court's jurisdiction. The lender will choose a law and a jurisdiction that are favorable to it and with which it is comfortable.

Absent a governing law or forum selection provision, a lender may have to litigate its action in a foreign jurisdiction. For example, if a foreign guarantor does not have sufficient ties to a U.S. state, a U.S. court in that state may not have power to assert its jurisdiction over the guarantor.

Generally, a governing law forum provision will be upheld, in the absence of fraud or misrepresentation, even if there is no apparent nexus between the parties, the transaction, and the jurisdiction chosen. Providing

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111. In addition to the waiver of notice provision in subparagraph (k), a guaranty should include an explicit provision with respect to waiver of notice and waiver of rights to subrogation and contribution. See infra part I.D of this article.

112. A catch-all provision may read:

The Guarantor waives any other circumstance whatsoever which might otherwise constitute a legal or equitable discharge, release or defense of a guarantor or surety, or which might otherwise exonerate or limit recourse against the Guarantor.


114. See Logan & Rowntree, supra note 57, ¶ 2.5, at 7. In multi-lender transactions, New York law or English law is typically selected. Id. Lenders are comfortable with those choices because these jurisdictions have "a substantial body of law in dealing with complex international finance... matters... rendering the predictability of outcome more certain." Id. At the very least, a lender does not wish to be exposed to litigation in a jurisdiction with laws and procedures alien to it.

115. The guarantor should also be asked to submit to the appointment of an agent for service of process in the United States so that the action may be more easily commenced. Id. at 8.

116. See Helicopteros Nacionales v. Hall, 466 U.S. 408 (1984). Having no presence generally means that the guarantor is not incorporated in and does not maintain an office or domicile in the state. See 1 RUDA, supra note 8, ¶ 11.04[7], at 11-17 to 11-18.

for the governing law of a guaranty simply requires stating the choice.\textsuperscript{118} Nevertheless, the validity and enforceability of the express choice of law under the laws of both the lender's and borrower's jurisdiction should be examined.\textsuperscript{119}

It is conceivable that a particular jurisdiction may evaluate the validity of the choice of law under its own law.\textsuperscript{120} There are two competing philosophies. First, a guaranty like any contract is a voluntary arrangement. Why should the courts interfere with the parties' decision? Second, a particular jurisdiction may have a strong interest in the contract. Why should these local interests be evaded?\textsuperscript{121} A lender should be aware of these underlying philosophies and should realize that a jurisdiction might not apply the chosen law in opposition to its own perceived interests.

For example, a guaranty contractually governed by English law that is breached in the United States may afford the lender an opportunity to commence an action in a U.S. court to enforce its rights under the guaranty. The question then is, will a U.S. court enforce English law? Whether a U.S. court

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\textsuperscript{118} Absent a specific designation, the parties to the guaranty leave themselves open to a court's judicial scrutiny to determine the governing law. Generally, courts will examine evidence in the guaranty itself to ascertain the parties' intent as to the choice of governing law. See \textit{Wood}, supra note 20, § 1.5(2), at 11. Failure to uncover the parties' intent will generally lead courts to examine the relationship between the parties, the transaction, and the jurisdiction alleged to be the governing law of the agreement to determine what is the governing law. \textit{Id.} § 1.5(4), at 13-15. This sort of uncertainty is best avoided.

\textsuperscript{119} See \textit{Logan & Rowntree}, supra note 57, § 2.5, at 7.

\textsuperscript{120} See \textit{id.; P.B. Carter, Contracts in English Private International Law, 1986 BRIT. Y.B. INT'L L.} 1, 7. Under English law, for example, "a limited number of specialized (but important) classes of contract are accorded individual treatment." \textit{Id.} Though not directly related to guaranties, contracts for the transportation of goods by sea or promissory notes under the Bills of Exchange Act of 1882 may merit special consideration with respect to the law applied in England. \textit{Id.} (citing the Bills of Exchange Act of 1882, §§ 83-89 (Eng.)).

In Bank Leumi Trust Co. v. Wulkan, 735 F. Supp. 72 (S.D.N.Y. 1990), a citizen of Israel who had entered into a guaranty with a bank sought to have the guaranty avoided on the ground that Israeli currency law invalidated it by precluding enforcement where payment was to be made in New York to a New York bank. \textit{Id.} at 74-76. The court ruled that under New York choice of law rules, a choice of law provision in a guaranty that designated New York law as the law to govern the agreement was enforceable, \textit{if the jurisdiction selected bore a "substantial relationship" to the agreement}. \textit{Id.} at 76. The court concluded that the Israeli currency law violated New York State public policy and was inapplicable under the doctrine of comity. \textit{Id.} at 76-77. The guaranty was therefore enforceable. The holding rested on the strength of the governing law provision and a court's recognition of it as binding and enforceable. \textit{Id.} at 77.
DRAFTING AN ENFORCEABLE GUARANTY

will effect an express choice of a foreign law is less a purely contractual problem (absent fraud or coercion) than a conflict-of-laws problem.\textsuperscript{122}

The analysis of whether a U.S. court will respect the choice of law clause depends on which of two routes the lender follows to enforce its rights.\textsuperscript{123} The first is having a U.S. court enforce a foreign judgment.\textsuperscript{124} This involves bringing an action in England and, assuming the clause is valid and enforceable in England, seeking to enforce that foreign judgment in the United States. The second aims to have the court apply the foreign law under the guaranty or apply the law of its jurisdiction in an action brought directly in a U.S. court.\textsuperscript{125}

1. Action on a Foreign Judgment

Apart from treaties or conventions signed by the U.S. government and a foreign country, U.S. states are not required to recognize or enforce a foreign judgment. Generally, however, U.S. courts will give effect to foreign judgments, except in unusual or exceptional circumstances.

The United States has not entered into any international conventions on the enforcement of foreign judgments. However, several states, including New York, have adopted the Foreign Money Judgments Recognition Act.\textsuperscript{126} Under that law, a foreign country judgment for a sum of money is enforceable in the same manner as the judgment by a court of that jurisdiction. But the implementation of this law has been so varied from state to state that it is difficult to generalize as to the outcome of an action to enforce a foreign judgment in a particular state court.

\textsuperscript{122} A country may examine its own conflict-of-laws rules to determine the validity of the designation of law. \textit{Id.} at 16. Under English law, as announced in Amin Rasheed Shipping v. Kuwait Ins. Co., 1984 App. Cas. 50 (1983)(appeal taken from Eng.), the doctrine of renvoi was rejected. Some scholars reason, however, that a court's application of foreign conflict-of-laws rules remains an unsettled question. \textit{Id.}

\textsuperscript{123} The conflict-of-laws rules in most foreign countries follow a two-step test to determine the validity of the designated choice of law. \textit{See} GRUSON \textit{et al.}, supra note 113, at 62-63. First, courts determine whether the validity of the contractual choice of law in the guaranty "is recognized in general." Second, they determine "whether there are limitations to the application of a validly chosen law." \textit{Id.} Generally, English courts abide by the choice of law of the parties to a commercial agreement. Carter, \textit{supra} note 120, at 10. If the chosen law would be contrary to public policy or the intent of the parties was to violate an English statute, then an English court may not enforce the choice. \textit{Id.} Under the EEC Convention on the Law Applicable to Contractual Obligations, Article 16, "the application of a rule of law of any country specified by this Convention may be refused only if such application is manifestly incompatible with the public policy of the forum." 1980 O.J. (L 266) 5. However, courts in England, France, Germany, Switzerland, Russia, Albania, Scandinavia, Japan, India, Thailand, and in the Spanish and Portuguese-speaking worlds, as well as in the United States, generally will uphold a choice of law. WOOD, \textit{supra} note 20, \S\ 1.4(1), at 7-8.

\textsuperscript{124} GRUSON \textit{et al.}, \textit{supra} note 113, at 84. Generally, an action to enforce a guaranty may be brought in a country which is not the country of the law chosen to govern the agreement. \textit{Id.}

\textsuperscript{125} \textit{Id.} The lender should be aware that a foreign court may not recognize the choice of law provision. \textit{Id.}

\textsuperscript{126} \textit{See} Foreign Money Judgments Recognition Act, \textit{N.Y. CIV. PRAC. L \& R.} \S\ 5303 (McKinney 1978).
Under New York law, generally, a foreign country judgment will be accorded recognition and be enforced under the doctrine of comity, absent a showing of fraud or some strong public policy consideration. This principle of law and the Foreign Money Judgments Recognition Act provide some assurance that a lender could act successfully to protect its rights in the United States under a foreign law guaranty. Nevertheless, it would be advisable to identify a jurisdiction of the United States as the chosen forum in the guaranty.

2. Action in a U.S. Court

If a lender were to bring an action directly in a U.S. state court (assuming a forum selection provision is incorporated into the guaranty) to enforce its rights under a guaranty, the question would become whether the court would apply the explicit choice of foreign law set forth in the guaranty, or another law.

The law of some U.S. states, including New York, is that the parties' express choice of law will be upheld even if it is not the law of the court having jurisdiction. However, if some unusual circumstance exists, as where the parties are attempting to evade some rule of law, then the court may not uphold the stated choice of law. If the parties freely consent to the choice of English law, for example, a New York court would likely apply the appropriate English law.

Assuming, however, that a New York court chooses not to apply English law, then it would apply the law most closely associated with the guaranty, as determined under its conflict-of-laws rules. If the laws of a U.S. state were selected, generally, a clause protecting the lender's rights would be valid and enforceable.

The rationale for abiding by a choice-of-law clause, uncoerced and freely negotiated, is that the parties to an agreement should be able to choose the law of their agreement. Thus, courts have recognized that a governing law provision is an essential bargained-for provision to be left to the discretion of the parties to the agreement, and not the courts. The same rationale applies when giving effect to the choice of forum.


128. If a court does not apply the intended law, it may examine the following factors: the domicile of the parties, the place of contracting, the subject matter of the transaction, the place of performance, and public policy considerations. 1 Logan & Rowntree, supra note 57, § 2.5, at 7. The laws of some countries require certain contracts to be governed by that country's laws. Id. Also see, Carter, supra note 120, at 6-7.

129. See 16 A.M. JUR. 2D Conflict of Laws § 78 (1979). Each state's conflict-of-laws rules must be examined to ascertain any limitations or circumstances whereby a court would not apply the chosen law. Id.

130. WOOD, supra note 20, § 1.4(1), at 7. Some courts may not give effect to a choice of law provision if it was chosen to evade a mandatory rule of law. Id. § 1.4(2)(c).

131. Id. § 1.4(1), at 7.
Submission to a particular forum or jurisdiction is generally upheld.\textsuperscript{132} A court may examine whether the selection of forum is proper under the governing law of the agreement and not the law of its jurisdiction.\textsuperscript{133} Alternatively, a court having jurisdiction may resort to its own conflict-of-laws rules to resolve this question. However, generally, "court[s] make people abide by their contracts."\textsuperscript{134} Courts will give effect to an exclusive forum selection in "freely negotiated private international agreements unaffected by undue influence or overwhelming bargaining power."\textsuperscript{135}

Under English law, the general rule of a court having \textit{in personam} jurisdiction over the guarantor is that the guarantor must be personally served.\textsuperscript{136} Under common law this involved some sort of notice. Today, appointment of an agent for service of process in conjunction with submission to the jurisdiction of a court explicitly set forth in the guaranty should suffice to obtain jurisdiction over the guarantor.\textsuperscript{137} Nevertheless, in English courts a guarantor which has submitted to jurisdiction may under certain circumstances seek a stay of the proceedings.\textsuperscript{138} The House of Lords has ruled in a case involving a personal jurisdiction issue that a defendant who satisfies the court that (1) another forum is less inconvenient and has jurisdiction over it, and (2) the plaintiff is not "deprive[d] . . . of a legitimate personal or juridical advantage . . . available to him if he invoked the jurisdiction of the English Court," may stay the English proceedings.\textsuperscript{139} Thus, jurisdiction is never assured, but the odds may be increased in the lender's favor by a jurisdictional clause in the guaranty.

III.

RECENT DEVELOPMENTS

A. Rulings Adversely Affecting Lenders

Recent U.S. cases have brought renewed attention to the enforceability of guaranties. In three notable cases, the courts' decisions were unfavorable
to lenders.\textsuperscript{140} Read alone, these decisions might call into question the wisdom of relying on a guaranty.\textsuperscript{141}

In recent years, banks have been forced to carry a greater number of troubled loans on their books. These bad loans have resulted in more bank foreclosures and loan work-outs. Foreclosure on a debtor's property is often necessary to recoup the loan monies advanced. Often, however, the proceeds recovered from the sale of the debtor's collateral do not adequately compensate the lender. The guarantor is then sought to account for the deficiency. If the guarantor is reluctant, its first defense is likely to be that the sale was not conducted in a commercially reasonable manner, \textit{i.e.}, the secured lender improperly administered or policed its loan, and this is what created the loss. The guarantor may claim that as a result of the lender's "poor management" of the collateral, fairness requires that the guarantor not be held responsible for the deficiency.

As discussed in Part II of this article, however, the guarantor's defense may be subject to attack by the lender. If the lender has incorporated waiver language in the guaranty, it may be able to recover its money from the guarantor on demand. By having the guarantor agree to waive its rights under the guaranty, a lender may avoid arguments as to what constitutes "mismanagement" or "unfairness" in the administration and policing of the loan.

However, in the United States, what is subject to waiver may differ from state to state. Whether a guarantor may waive the defense that the lender disposed of its collateral in a commercially unreasonable manner is subject to conflicting judicial rulings.\textsuperscript{142}

The issue centers on U.S. courts' interpretation of § 9-504(3) of the Uniform Commercial Code ("U.C.C." as adopted in their jurisdictions. Section 9-504(3) provides:

\begin{quote}
[The] [s]ale or other disposition [of collateral] may be ... at any time and place and on any terms but every aspect of the disposition including the method, manner, time, place and terms must be commercially reasonable.\textsuperscript{143}
\end{quote}

Section 9-501(3) provides:

\begin{quote}
\textsuperscript{140} See Bank of China v. Chan, 937 F.2d 780 (2d Cir. 1991); General Elec. Credit Corp. v. Murphy (\textit{In re Rodriguez}), 895 F.2d 725 (11th Cir. 1990); Levit v. Ingersoll Rand Fin. Corp. (\textit{In re Deprizio Constr. Co.}), 874 F.2d 1186 (7th Cir. 1989).

\textsuperscript{141} At least under certain circumstances, the effects of certain rulings have caused some to question the enforceability of guaranties. See Peter L. Borowitz, \textit{Waiving Subrogation Rights and Conjuring Up Demons in Response to Deprizio}, 45 BUS. LAW. 2151, 2165 (1990)(discussing "cascade effect" of \textit{Deprizio}, 874 F.2d at 1186, which held that payment made by a debtor more than ninety days but less than one year before bankruptcy on a loan guaranteed by an insider may be avoided and recovered from the lender). The value of guaranties is also undermined by the difficulty of locating or reaching the guarantor's assets, the difficulty of locating the guarantor itself, and the multiple guaranty commitments made by some guarantors.

\textsuperscript{142} Given the uncertainty of the law on this issue, it is prudent for the lender to establish and abide by a set of principles for the disposition of collateral by formalizing the lender's present policy in writing and having it reviewed by the lender's in-house or outside counsel.

\textsuperscript{143} U.C.C. § 9-504(3) (1990).
\end{quote}
To the extent that they give rights to the debtor and impose duties on the secured party, the rules stated in [§ 9-504(3)] may not be waived or varied.

Several courts have disagreed on whether this provision applies solely to debtors, according to the black letter of the law, or whether the drafters of the U.C.C. intended it to include guarantors. If Section 9-504(3) is found to apply to guarantors, the U.C.C. dictates that the sale be conducted in a "commercially reasonable" manner and such requirement may not be waived. If so, failure to properly dispose of the debtor's collateral may cause the release of the guarantor from all liability or reduce its liability.

In Bank of China v. Chan, the U.S. Court of Appeals for the Second Circuit reversed the district court's holding and ruled that, under New York law, a guarantor may not waive the defense that the sale of collateral be commercially reasonable.

In Chan, the court reasoned that the definition of debtor under Article 9 of the U.C.C. is broad enough to include a guarantor and found no indication that the drafters of the U.C.C. intended the exclusion of guarantors. To the lender's chagrin, the guarantor in Chan, as a result of this ruling, was entitled to a possible reduction in or release from his obligations under the guaranty.

The question then arises whether the lender should include a waiver of commercially reasonable foreclosure sale in its form guaranty. Under U.S.

144. Id. § 9-501(3).
146. The U.C.C. also requires that notice be given to the "debtor," which requirement may only be waived if the debtor has renounced or modified his right to notification. Accordingly, a guarantor may make an analogous argument that it is a "debtor" for purposes of receiving a notice. U.C.C. § 9-504(3); see also Barnett v. Barnett Bank, 345 So. 2d 804 (Fla. Dist. Ct. App. 1980); cf. Bank of Oklahoma v. Little Judy Indus., Inc., 387 So. 2d 1002 (Fla. Dist. Ct. App. 1980).
147. 937 F.2d 780 (2d Cir. 1991).
148. Id. at 786.
149. See id. This conclusion contradicts a recent finding under Virginia law as discussed supra part III.B of this article.
150. The holding in Chan is also notable because the court held that the U.C.C. imposed a duty of good faith and fair dealing upon a lender to satisfy implicit conditions under a loan agreement in order to avoid the release of the guarantor. Id. at 789. In Chan, the corporate debtor was to supply semiconductor components to businesses operated by the Chinese government. Id. at 782. As security for working capital and a letter of credit for the debtor, the guarantors entered into a guaranty and a "master" letter of credit was issued by the bank for the account of the debtor's customers. Id.

The bank was to draw down the master letters of credit when proper collection documents were provided and remit all payments to the debtor corporation. Id. The bank failed to draw down on the master letters of credit which precipitated the liquidation of the debtor. Id. at 788. Thereafter, the bank sought to recover the deficiency from the guarantors. Id. at 782. The Court held that if it is determined that the bank acted in bad faith in not drawing down on the letters of credit, this act served as a complete defense to the guarantor and remanded the case to the trial court. Id. at 792.
law, most jurisdictions probably would not uphold such a waiver provision, reasoning that the guarantor is a "debtor" under the U.C.C., and therefore that such a right may not be waived. Such a waiver provision may therefore not be enforceable. Nevertheless, it is prudent to include, but not rely upon, such a provision in a lender's form guaranty for purposes of U.S. law. Some U.S. states may uphold the waiver's validity. In England such a provision would likely be enforceable.

Another case which aroused concern among secured creditors was *Levit v. Ingersoll Rand Fin. Corp. (In re Deprizio Constr. Co.)*. In *Deprizio*, the U.S. Court of Appeals for the Seventh Circuit held that payments made to a lender within one year prior to a filing for bankruptcy may be recovered as a "preference" if the debt was guarantied by an "insider" of the debtor. Under Section 547(b) of the U.S. Bankruptcy Code, a trustee may avoid any transfer of the debtor's property made between 90 days and one year prior to a bankruptcy filing as a preference if the creditor was an "insider" and had reasonable cause to believe that the debtor was insolvent.

The guarantor may challenge the commercial reasonableness of a foreclosure sale on many grounds. The process is filled with hazards for the lender and if not properly conducted can easily lead to a successful challenge. For example, if a lender did not secure an adequate number of bids, or the sale was not properly publicized, or a precipitous public auction was held when a better price was obtainable, a court may rule that the sale was commercially unreasonable. For a list of twenty-four defenses that a guarantor may raise, see *Secured Lending Alert*, supra note 47, at 6-8. The guarantor is especially likely to allege such defects in the process if a deficiency has to be covered. Ideally, a secured lender could avoid such arguments by relying on a waiver provision.

The following provision is a typical waiver with respect to the commercial reasonableness of a foreclosure sale:

The lender may, at its election, foreclose on any security held by the lender by means of one or more judicial or nonjudicial sales, whether or not every aspect of any such sale is commercially reasonable.

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154. 874 F.2d 1186 (7th Cir. 1989).

155. Id. at 1200-01. Under the Bankruptcy Code "insider" means any director, officer, or person in control of the debtor if the debtor is a corporation. See 11 U.S.C. § 101(b)(31) (1988).

156. Section 547(b) reads:

[T]he trustee may avoid any transfer of an interest of the debtor in property (1) to or for the benefit of a creditor; (2) for or on account of an antecedent debt owed by the debtor before such transfer was made; (3) made while the debtor was insolvent; (4) made (A) on or within 90 days before the date of the filing of the petition; or (B) between ninety days and one year before the date of the filing of the peti-
The court reasoned that a transfer by a debtor to an outside creditor made for the benefit of an insider guarantor was avoidable under Section 547 of the Bankruptcy Code and was recoverable from the outside creditor under Section 550 of the Bankruptcy Code. The creditors argued that such a transfer to outside lenders was not avoided under Section 547 since recovery may only be obtained from those to whom the transfer was a preference. The court rejected this argument, and reasoned that an estate preserved in the aggregate for the benefit of all creditors was worth more than its dismantled remnants.

One way to resolve the "insider-guaranty" problem has been suggested by the addition of a waiver provision as to the guarantor's status as a creditor:

Guarantor hereby irrevocably waives all legal and equitable rights to recover from the Debtor any sums paid by the Guarantor under the terms of this Guaranty, including without limitation all rights of subrogation and all other rights that would result in Guarantor being deemed a creditor of Debtor under the federal Bankruptcy Code or any other law.

Finally, brief mention is warranted of the laws of fraudulent conveyance and their effect on a guarantor's obligation to a lender. In the United States the laws of fraudulent conveyance prohibit a transfer of a guarantor's assets without receiving "fair consideration" or "reasonably equivalent value" in exchange for the transfer. These laws protect a creditor from fraudulent transfers designed to strip a corporation of its assets. Foreign jurisdictions, including England, have a form of fraudulent conveyance law, but only in the United States does it appear to have been heavily litigated. A twist on this type of transaction occurred in General Electric Credit Corp. v. Murphy (In re Rodriguez).

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157. Deprizio, 874 F.2d at 1198. Section 550 specifies that an avoided transfer under § 547 is recoverable from the initial transferee or the entity for whose benefit such transfer was made. 11 U.S.C. § 550. See generally David I. Katzen, Deprizio and Bankruptcy Code Section 550: Extended Preference Exposure Via Insider Guarantees, and Other Perils of Initial Transferee Liability, 45 Bus. Law. 511 (1990).
158. Deprizio, 874 F.2d at 1196.
159. Id. at 1194. The court concluded its holding would discourage insolvent corporations from making preferential payments on loans guarantied by their officers and directors. Id.
161. See Insolvency Act, 1986, § 238 (Eng.). This section provides that a court may rescind a transaction at an undervalue. At present only one case has been considered under § 238, and it did not concern a guaranty. See Re MC Bacon Ltd., 1990 B.C.L.C. 324 (1989)(Eng. Ch.).
162. 895 F.2d 725 (11th Cir. 1990).
The case involved a Chapter 7 bankruptcy proceeding under which the trustee sought to recover payments to a creditor made by a corporate debtor on behalf of its subsidiary for the purchase of a corporate jet. Rather than defraud the lender by transferring its assets to a third party, here the alleged fraudulent conveyance was against the trustee in bankruptcy by transfer to the lender.

The U.S. Court of Appeals for the Eleventh Circuit affirmed the lower court’s ruling that the payments by the parent debtor were not supported by a "reasonably equivalent value," and that therefore the transfer was a fraudulent conveyance. The court found that the parent corporation did not benefit by a reduction in its subsidiary’s indebtedness, since a parent corporation is normally not responsible for the liabilities of its subsidiary. In addition, the court noted that the debtor parent corporation did not benefit from the use of the plane itself. Thus, the trustee prevailed over the lender.

In order for a guaranty to be deemed a fraudulent conveyance, the debtor must not have been solvent at the time it entered into the guaranty or be rendered insolvent by it. A practical solution is to "cap" the guaranty at an amount that would not cause the guarantor to be insolvent. This can be done by ascertaining an exact amount that may cause insolvency and limiting the guaranty to some amount less than that figure. Other more exotic means exist to cap a guaranty, such as defining the guaranty amount as fluctuating in relation to the assets or liabilities of the guarantor.

163. Id. at 726-27.
164. Id. at 728.
165. Id. at 729.
166. Id.
167. Id. A more common problem, though one not discussed in detail in this article, is “upstream” guaranties. Such guaranties occur, generally, when a subsidiary guaranties the obligations of its parent. There is said to be no "benefit" derived by the subsidiary. However, some favorable rulings to lenders have developed. In Chase & Sanborn Corp. v. Arab Banking Corp., 904 F.2d 588 (11th Cir. 1990), the trustee of a Chapter 11 corporate debtor brought an action to recover payments of money totalling approximately $4 million by the debtor corporation toward satisfaction of a $22 million loan obligation of the individual owner, i.e. the "parent," of the debtor corporation. Id. at 592. The loan obligations were guaranteed by the corporate debtor in return for $370 thousand in loan proceeds. Id. at 591-92. The trustee alleged that the payments were fraudulent conveyances. Id. at 592.

The court ruled that the payments under the guarantee in satisfaction of the parent’s loan obligations were not fraudulent conveyances because the contingent liability under the guarantee constituted "reasonably equivalent value" in relation to the $370 thousand in loan proceeds received by the debtor corporation. Id. at 594-95. Although the $370,000 in loan proceeds received by the debtor corporation was far less than the $22 million guarantee amount, the court reasoned that "a contingent liability cannot be valued at its potential face amount" and noted the loan was secured by other means. Id. The court concluded that the lower courts’ rulings that the $370 thousand in loan proceeds received was a reasonably discounted amount equivalent to the debtor corporation’s contingent liability were not clearly erroneous. Id. at 595.

B. Recent Rulings Favorable to Lenders

The rulings discussed above should not overshadow most U.S. courts' rulings consistently upholding the validity of challenged guaranties.

Contrary to the ruling in Chan, the District Court in Chrysler Credit Corp. v. Curley ruled that an explicit waiver of notice and waiver of "any right to object to the commercial reasonableness of the collateral disposition" in personal guaranties barred any defense of the guarantors that they had not received adequate notice of the sale of collateral, and that the sale had not been conducted in a commercially reasonable manner. The court held the guarantors liable for the deficiency due the creditor after receipt of the sale proceeds.

Furthermore, the court ruled that the explicit notification requirement and anti-waiver provision under the Uniform Commercial Code of the Commonwealth of Virginia was inapplicable to guarantors. The statute specifically provides that: "[t]o the extent that [the notification requirements] give rights to the debtor... [the requirement]... may not be waived or varied..." The court declined to extend the anti-waiver provision to guarantors reasoning that "courts should not adopt an absolute bar that is in derogation of the freedom to contract and the principles of common law waiver. To adopt an absolute bar on waiver in this context inappropriately assumes a legislative role for the courts."

The court further reasoned that the guarantor was not without recourse if the sale was conducted unreasonably. The court noted that a sale of collateral not undertaken in "commercial good faith" or that represents "wilful or grossly negligent waste or misconduct" is subject to scrutiny by a court.

The court's holding suggests that U.S. courts will generally uphold the traditional law of guaranties. As discussed in Part II.E of this article, the law of waiver comprises an essential component in drafting an enforceable guaranty. This ruling, though it is important, should be viewed with caution. The law of commercially reasonable disposition is fraught with dangers. In Chrysler the court found no basis for the contention that the sale of the collateral was not conducted in good faith or was unreasonable.

\[169. \text{ 753 F. Supp. 611 (E.D. Va. 1990).} \]
\[170. \text{Id. at 617.} \]
\[171. \text{Id. at 621.} \]
\[172. \text{Id. at 616-17.} \]
\[173. \text{Id. at 614.} \]
\[174. \text{Id. at 619.} \]
\[175. \text{Id. at 618. See United States v. Lair, 854 F.2d 233 (7th Cir. 1988); United States v. Willis, 593 F.2d 247 (6th Cir. 1979); First Nat'l Park Bank v. Johnson, 553 F.2d 599, 602 (9th Cir. 1977); United States v. Andresen, 583 F. Supp. 1084, 1086 (W.D. Va. 1984).} \]
\[176. \text{Chrysler, 753 F. Supp. at 618. In England, it has been held that a bank has no duty vis-a-vis the surety to sell collateral to avoid reduction of the value of securities held as collateral. See China & South Sea Bank Ltd. v. Tan, 1990 App. Cas. 536 (P.C. 1989)(appeal taken from H.K.). A lender should ensure that such sale is conducted fairly and in accordance with common commercial standards in effect at such time in the particular jurisdiction.} \]
sive and well drafted guaranty will strengthen the likelihood of a favorable ruling.

IV. CONCLUSION

The lender should remember that the provisions of a guaranty may be construed against the person drafting the agreement, which in an international financing transaction is likely to be the lender. This article has attempted to review old and new concepts and provisions in the law of guaranties and the problems of enforceability that a loan guaranty attempts to resolve. Its emphasis is on careful attention to the terms used when drafting a guaranty to forestall litigation. Careful drafting may also ensure that the guarantor is amenable to action in the courts under the law chosen by the lender. Implementing the provisions and concepts discussed here may provide the lender with the security intended to be established by a guaranty.