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LAWYERS WHO DRAFT AND NEGOTIATE GUARANTIES (AND THE CLIENTS WHO LOVE THEM)*

TIMOTHY R. ZINNECKER**

Recent bestseller lists have often included legal thrillers, many of which Hollywood has successfully converted into box-office blockbusters.1 Wishing to respond to the public's apparently insatiable desire to live vicariously in the riveting world of jurisprudence, ABC—the Attorney Broadcasting Corporation—has recently offered a channel devoted exclusively to law-related entertainment. One of its most-watched programs is the award-winning, prime-time talk show, "Obiter Dicta."2 Let's drop in on today's episode being taped to air during the crucial "sweeps week."

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* With apologies to Geraldo, Phil, Jerry, Regis and Kathie Lee, Sally Jessy, Montel, Maury, Ricki, Vicki, Jane, Jenny, and Oprah. Is it only me, or has anyone else noticed that "Oprah" spelled backwards is "Harpo"? Could Oprah Winfrey and Harpo Marx actually be the same person? Have you ever seen them together? Hmmmm. Sounds like an excellent topic for a talk show. And another thing. Do you realize that "Evian" spelled backwards is "Naive"? Subliminal marketing, perhaps? But I digress.

** Assistant Professor of Law, South Texas College of Law. I conducted much of my research while practicing in the banking department in the Houston office of Johnson & Gibbs, P.C. I wish to thank that firm for the resources it made available to me. I also appreciate the comments offered on earlier drafts of this article by James D. Gordon, III, Alan I. Inglis, Kenneth A. Rogers, and Shelton M. Vaughn, although mentioning their names in no way implicates them for including herein any erroneous legal conclusions, misstatements of law, extremist views, Bluebook errors, or vain attempts at humor. I am only too happy to lay the blame for such flaws—if any truly exist—on the one person most responsible for the way I am today: cartoonist Gary Larson.

1. Although not a blockbuster, one of my favorite movies with a legal theme is Body Heat (starring William Hurt, Kathleen Turner, and, in a bit role, Ted Danson, who wears a style of glasses that I thought only my father owned). Any movie that can weave the Rule Against Perpetuities into the plot is definitely worthy of citation. This footnote is dedicated to my property professor, who first introduced the Rule Against Perpetuities to me and then proceeded to give me one of my lowest grades in law school. I hope this footnote dedication eases the remorse and guilt that no doubt continue to haunt her.

2. Latin for "Dick has an overbite."

3. Many lawyers would love to meet the proverbial "reasonable man." I, however, yearn for the day when I come face to face with a member of a "Nielsen family" and finally obtain answers to the following questions that have nagged me for years: Do you receive a free subscription to TV Guide? Can you leave the room during commercials? And why didn't you watch The Paper Chase more often in the 1970s and St. Elsewhere more often in the 1980s?

For a light-hearted look at the role the reasonable man has played in defining standards of
EP: Hello everyone, and welcome to *Obiter Dicta*. I’m your host, Elliott Pennoyer.¹ Today I’ve invited two distinguished members of the Texas Bar to join me for what promises to be a fascinating discussion of how to draft and negotiate a guaranty. With me, from the Dallas boutique firm² of Six Incredibly Talented Lawyers, is Miranda Douglas, and from the Houston firm of Gready, Grumpie, and Rood, is Howard Cronin. Together they bring to the show more than thirty-five years of experience representing corporations and financial institutions in a variety of commercial transactions. Miranda, why don’t you give us a hypothetical transaction for purposes of today’s discussion.

MD: All right. BigBank agrees to loan $100,000,000 to XYZ Company for general corporate purposes. Repayment will be secured by a lien on the assets of XYZ Company and its subsidiaries. Additionally, XYZ’s parent—let’s say ABC Inc.—will execute a stock pledge agreement and a guaranty. All documents will be governed by Texas law.³

EP: So ABC will be our guarantor. Two questions, Howard. What is a guaranty? And must it be in writing to be enforceable?

HC: I would define a guaranty as an undertaking by a party to answer for the payment of some debt or the performance of some contract of another party upon that party’s default.⁴ In this case, ABC will undertake to repay XYZ’s debt to BigBank if XYZ fails to do so. ABC’s guaranty will not be enforceable unless it is in writing and signed by someone lawfully authorized to sign on ABC’s behalf, such as a corporate officer.⁵ The

¹. My therapist believes that most of my abnormal behavior (including the use of such an unusual surname for a television personality) can be traced to the mind-numbing trauma (not to mention the temporary muteness and cranial meltdown) induced on my first day of law school when my civil procedure professor began his lecture by glancing at the class roster and uttering these chilling words: “Mindful of the scriptural admonition that the last shall be first ....”

². A boutique firm is a collection of a few lawyers, each of whom is a member of the Order of the Coiffure.

³. If I were to discuss the collateral in any detail, I of course would refer to the real estate as Blackacre—again in an effort to prove to my property professor that I was paying attention in class. See *supra* note 1.

⁴. See United States v. Vahlco Corp., 800 F.2d 462, 465 (5th Cir. 1986); see also Republic Nat’l Bank v. Northwest Nat’l Bank, 578 S.W.2d 109, 114 (Tex. 1978) (“A true guaranty creates a secondary obligation whereby the guarantor promises to answer for the debt of another and may be called upon to perform once the primary obligor has failed to perform.”).

⁵. See *Tex. Bus. & Com. Code Ann.* § 26.01(a), (b)(2) (Vernon 1987). For cases involving an oral guaranty, see *Bass v. Fouts*, 400 S.W.2d 15 (Tex. Civ. App.—Texarkana 1966, writ ref’d n.r.e.) (ruling that defendants who were not signatories to notes could not be held liable on any alleged oral guaranties of the notes); *Hein v. John Finnigan Co.*, 163 S.W. 124 (Tex. Civ. App.—San Antonio 1914, no writ) (holding oral agreement by father to guaranty advances made
moral of the story? An oral guaranty is not worth the paper it’s written on. 9

EP: (turning to the camera) Wow! A lawyer with a sense of humor. Perhaps I can get him a spot on Ripley’s Believe It Or Not or That’s Incredible! (returning to his panelists) If we have a written guaranty, how will a reviewing court resolve any disputes concerning its terms?

MD: A court’s primary concern will be to ascertain the intent of the parties. 10 However, because a guarantor is a so-called favorite of the law, 11 the guaranty will be construed strictly in its favor. 12 With this in mind, lender’s counsel—who usually prepares most of the loan papers—should draft the guaranty with clarity and completeness and strive to avoid ambiguity. 13

EP: Well, without further ado, let’s examine a sample guaranty that BigBank might ask ABC to execute. We asked Miranda and Howard to provide a mutually agreeable first draft of a guaranty that BigBank’s attorney might submit to ABC and its counsel for review and comment. This draft has been circulated to members of our studio audience and relevant provisions will appear on the screens of our many television viewers. I’ll introduce the provisions and ask my guests to offer reasons for inclusion

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9. Egads! A dangling preposition!! As William Safire once said, "Is sloppiness in speech caused by ignorance or apathy? I don’t know and I don’t care." ROBERT BYRNE, 1,911 BEST THINGS ANYBODY EVER SAID 100 (1988).

10. See Resolution Trust Corp. v. Cramer, 6 F.3d 1102, 1106 (5th Cir. 1993); Coker v. Coker, 650 S.W.2d 391, 393 (Tex. 1983).

11. Unlike the law, my parents refused to play favorites—even though I was an only child.

12. See United States v. Vahlco Corp., 800 F.2d 462, 465 (5th Cir. 1986); see also Cramer, 6 F.3d at 1102 (holding if guaranty contains an ambiguity, it should be construed in favor of the guarantor); Resolution Trust Corp. v. Northpark Joint Venture, 958 F.2d 1313, 1320 (5th Cir. 1992), cert. denied, 113 S. Ct. 963 (1993) (holding if the guaranty is ambiguous, court must apply construction most favorable to guarantor); Coker, 650 S.W.2d at 394 n.1 ("A guarantor is entitled to have his agreement strictly construed so that it is limited to his undertakings, and it will not be extended by construction or implication. Where uncertainty exists as to the meaning of a contract of guaranty, its terms should be given a construction which is most favorable to the guarantor.") (citations omitted); Tenneco Oil Co. v. Gulsby Eng’g, Inc., 846 S.W.2d 599, 605 (Tex. App.—Houston [14th Dist.] 1993, writ denied) ("A guaranty agreement is to be strictly construed and shall not be extended beyond its precise terms by construction or implication."); Clark v. Walker-Kurth Lumber Co., 689 S.W.2d 275, 278 (Tex. App.—Houston [1st Dist.] 1985, writ ref’d n.r.e.) ("Where uncertainty exists as to the meaning of a contract of guaranty, and where two reasonable constructions may be made, the reviewing court will apply the construction more favorable to the guarantor.").

13. Lender’s counsel should also strive to avoid being repetitious and redundant.
and changes likely to be requested by ABC or its counsel. Miranda, why
don’t you discuss the opening paragraph and the recitals.

GUARANTY

This Guaranty is executed as of ______________, 1994, by
ABC Inc. ("Guarantor") for the benefit of BigBank ("Lender").

Recitals

A. XYZ Company ("Borrower") and Lender have executed a
credit agreement as of the date of this Guaranty (as amended, supple-
mented, or restated, the "Credit Agreement"), together with certain
other Loan Papers.

B. Borrower is a wholly-owned subsidiary of Guarantor.

C. The execution and delivery of this Guaranty is a require-
ment to Lender’s execution of the Credit Agreement and the other
Loan Papers and is an integral part of the transactions contemplated
by the Loan Papers and a condition precedent to Lender’s obligations
to extend credit under the Credit Agreement.

MD: My only comment on the opening paragraph is that the execu-
tion date on the guaranty is not essential to its validity. However, we’ll
see in a moment its importance for other reasons.

Let’s first examine the shortest recital, recital B. My personal prefer-
ence is to state the relationship that exists between the guarantor and the
borrower. This statement, however, is optional. In fact, the law does not
mandate that any relationship exist between the guarantor and the
borrower.

Recital C is included because it establishes prima facie evidence of
consideration. BigBank is agreeing to extend credit and other contractual
benefits to XYZ on the condition that ABC agrees to guaranty repayment of
the loan.

EP: But the extension of credit flows to XYZ, the borrower, rather
than ABC, the guarantor. Aren’t you concerned about having the enforce-
ability of your guaranty challenged on grounds of failure of consideration?

MD: No. Numerous cases hold that consideration moving solely to
the borrower is sufficient to bind a guarantor. However, a consideration

15. See 68 Tex. Jur. 3d Suretyship and Guaranty § 141 (1989) ("It is not necessary that a contractual relationship exist between the principal obligor and the guarantor."). But try persuad-
ing a complete stranger to guaranty your house mortgage or car loan!
16. See, e.g., Cortez v. National Bank of Commerce, 578 S.W.2d 476, 480 (Tex. Civ. App.—Corpus Christi 1979, writ ref’d n.r.e.) ("A number of courts, including our Supreme Court, has [sic] held that to support a contract of guaranteeship, it is not necessary that any consideration pass directly to the guarantor. A consideration moving to the principal alone will suffice to bind the guarantor where the note evidencing the primary obligation and the guaranty agreement are executed contemporaneously. See Bonner Oil Co. v. Gaines, 108 Tex. 232, 191 S.W. 552
(1917) . . ."); Barclay v. Waxahachie Bank & Trust Co., 568 S.W.2d 721, 724 (Tex. Civ. App.—
problem may exist when the guaranty is executed after BigBank already has advanced the loan proceeds to XYZ. In that situation, some new consideration must exist to support the guaranty.\textsuperscript{17} If you're thinking that funds advanced under the credit agreement but after delivery of the guaranty suffice, think again.\textsuperscript{18} BigBank must incur a new detriment or provide an additional benefit not previously contracted for.

EP: So, if possible, the guaranty should be executed contemporaneously with the credit agreement and the other loan papers, unless the loan papers expressly make BigBank's agreement to advance funds contingent upon its receipt of ABC's guaranty. I guess you include recital A in the guaranty for evidentiary reasons relating to this issue.

MD: Precisely. It also provides me with two defined terms that are used throughout the document: "Borrower" and "Credit Agreement."

EP: OK. Howard, why don’t you introduce us to the first two substantive paragraphs of the guaranty and offer reasons why BigBank's coun-

\begin{quote}
Waco 1978, no writ) ("It is not necessary that consideration for the guaranty pass to the guarantor, for it is sufficient consideration if the primary debtor receives some benefit."); Hargis v. Radio Corp. of America, 539 S.W.2d 230, 232 (Tex. Civ. App.—Austin 1976, no writ) ("Consideration for a guaranty agreement usually consists of either the sufferance of a detriment by the creditor or a benefit conferred by the creditor on the primary debtor.").

Additionally, several commentators have concluded that consideration does flow to the parent-guarantor because the capital stock of the subsidiary-borrower is an asset of the parent-guarantor. Therefore, the credit extended by the lender inures indirectly to the benefit of the parent-guarantor. See, e.g., Kenneth J. Carl, Fraudulent Transfer Attacks on Guaranties in Bankruptcy, 60 Am. Bankr. L.J. 109, 115 (1986); David S. Walls, Promises to Keep: Intercorporate Guarantees and Fraudulent Transfers in Bankruptcy, 19 UCC L.J. 219, 224–28 (1987); see also Waller v. Missouri City State Bank, 482 S.W.2d 40, 43 (Tex. Civ. App.—Tyler 1972, writ ref'd n.r.e.) ("In this instance the Bank's implied promise to advance additional funds amounted to consideration flowing not only to the principal debtor, but also, through it, to appellant as a stockholder-guarantor.").

17. See Fourticq v. Fireman's Fund Ins. Co., 679 S.W.2d 562, 564 (Tex. App.—Dallas 1984, no writ) ("If the promise of the guarantor is made contemporary to the promise of the primary debtor, the consideration which supports the primary debtor's promise also supports that of the guarantor. If, however, a contract of guaranty is entered into independently of the transaction which created the primary debt or obligation, the guarantor's promise must be supported by consideration distinct from that of the primary debt."); see also Sunbelt Sav., FSB v. Barr, 824 S.W.2d 600, 602 (Tex. App.—Dallas 1991), rev'd on other grounds, 837 S.W.2d 627 (Tex. 1992) ("[A] guaranty is often executed contemporaneously with the note that the guaranty collateralizes, and, when they are, the lender's willingness to make the loan evidenced by the note is itself consideration for the guaranty."); cf. Maykus v. Texas Bank & Trust Co., 550 S.W.2d 396, 398 (Tex. Civ. App.—Dallas 1977, no writ) ("[M]ere evidence of a time discrepancy in execution between a note [dated August 8, 1973] and a written guaranty agreement [dated August 15, 1973] is legally insufficient to rebut the statutory presumption of consideration which supports a separate guaranty accord.").

18. See Fourticq, 679 S.W.2d at 565 ("We hold that for future indebtedness to constitute consideration in a situation in which a guaranty is signed separately and subsequent to the incurring of the primary indebtedness, the future indebtedness must be indebtedness not previously contracted for by the parties.").
\end{quote}
sel includes them in the document. Miranda, please jump in with any observations from the perspective of ABC’s counsel. Later, I’ll ask you to switch roles. 19

Agreement

1. Guaranty. Guarantor guaranties to Lender the prompt payment at maturity (by acceleration or otherwise), and at all times thereafter, of the Guaranteed Debt (defined below), according to the following paragraphs.

2. Definitions. Unless otherwise stated, terms defined in the Credit Agreement have the same meanings when used in this Guaranty. The term “Borrower” includes its successors (by merger, consolidation, dissolution, or otherwise, including, without limitation, Borrower as a debtor-in-possession and any party hereafter appointed for Borrower or all or substantially all of its assets under any Debtor Relief Law). The term “Guaranteed Debt” means the Obligation, together with (a) amounts that would be part of the Obligation but for operation of any applicable provision of Title 11 (“Bankruptcy”) of the United States Code, (b) all pre- and postmaturity interest thereon (including, without limitation, all postpetition interest provided for under the Loan Papers if Borrower voluntarily or involuntarily files for bankruptcy protection and regardless whether Lender is entitled to recover that interest from Borrower), and (c) any and all costs, attorneys’ fees, and expenses reasonably incurred by Lender to enforce Borrower’s, Guarantor’s, or any other obligor’s payment of any of the foregoing indebtedness.

HC: The first paragraph provides the operative language, “Guarantor guaranties,” which BigBank wants to see somewhere in the guaranty. The paragraph also indicates that ABC’s payment obligations are not limited to any particular date. Rather, its payment obligations may come due before any scheduled maturity date—for example, if BigBank accelerates payment following a default by XYZ—and will continue thereafter until satisfied.

The first sentence of the second paragraph is standard in many guaranty documents and permits the parties to use terms defined in the credit agreement—many of which may be rather lengthy—without restating them verbatim in the guaranty. For example, this guaranty uses the terms “Debtor Relief Law,” “Default,” “Loan Papers,” and “Obligation,” each of

19. Many lawyers might refer to this as a switching of hats. For example, counsel for a lender might say to his client, “Well, if I were wearing my borrower’s hat, I’d have the following comments on this nefarious, draconian, and overreaching document.” The reference is anachronistic, however, as few, if any, lawyers or clients actually wear hats today. Perhaps another article of clothing should be referenced. Many come to mind, but none has only one syllable of three letters. Because many lawyers allegedly (a word that saves me from a defamation action) charge by the letter or syllable—rather than the rumored 20-second blocks rounded upward to the nearest hour—perhaps clients are best served by no change.
which will be defined in the credit agreement between BigBank and XYZ.²⁰

The second sentence expands the definition of Borrower. Normally, the credit agreement prohibits XYZ from merging or consolidating with another entity or filing articles of dissolution. Thus, its contrary action, as well as its bankruptcy, will trigger a default—which permits BigBank to seek payment from ABC under paragraph 4 of the guaranty. ABC may concede that a default exists, but argue that it is not liable under the guaranty because it only guaranteed payment of debts owed by XYZ—which may not technically or legally exist after its bankruptcy, corporate restructure, or dissolution. The expanded definition of Borrower should rebut ABC’s argument.²¹

In my opinion, the final sentence of the second paragraph may be the

²⁰. Typically some variation of the following definitions will be found in the credit agreement:

“Debtor Relief Laws” means the Bankruptcy Code of the United States of America and all other applicable federal or state liquidation, conservatorship, bankruptcy, moratorium, rearrangement, receivership, insolvency, reorganization, suspension of payments, or similar laws affecting creditors’ rights.

“Loan Papers” means (a) this credit agreement, certificates and reports delivered under this credit agreement, and exhibits and schedules to this credit agreement, (b) all agreements, documents, and instruments in favor of Lender ever delivered under this credit agreement or in connection with all or any part of the Obligation, and (c) all renewals, extensions, and restatements of, and amendments and supplements to, any of the foregoing.

“Obligation” means all present and future indebtedness and obligations, and all renewals, increases, and extensions thereof, or any part thereof, now or hereafter owed to Lender by Borrower or any related entity under any Loan Paper, together with all interest accruing thereon, fees, costs, and expenses (including, without limitation, all attorneys’ fees and expenses incurred in the enforcement or collection thereof) payable under the Loan Papers or in connection with the protection of rights and remedies under the Loan Papers.

Often, the definition of “Default” refers the reader to a particular section in the credit agreement for provisions that describe events deemed a default. Such events usually include failing or refusing to make a loan payment when due, breaking a covenant, making a misrepresentation, defaulting under a material contract, being the subject of a voluntary or involuntary bankruptcy proceeding, or wearing a green leisure suit in public.

²¹. See, e.g., Chambers v. NCNB Texas Nat’l Bank, 841 S.W.2d 132, 134 (Tex. App.—Houston [14th Dist.] 1992, no writ) (ruling that guarantor remained liable for debt incurred by partnership after incorporation because guaranty stated change in status of debtor by “merger, consolidation or otherwise” would not alter guarantor’s liability).

Unless an existing guaranty expressly states that the guarantor’s liability extends to postpetition financing, the postpetition lender should require the guarantor to execute a new guaranty as a prerequisite to funding any postpetition loan. Otherwise, the guarantor may not be liable for the postpetition loans. See Bank of New England, N.A. v. Klein, 86 B.R. 897 (S.D. Tex. 1988) (holding that in absence of any contrary language in guaranty, guarantor was not liable for postpetition financing to borrower because debtor-in-possession was entity distinct from borrower).

Postpetition financing is referred to as DIP lending (“DIP” being an acronym for “debtor-in-possession”). Hindsight usually reveals whether the postpetition lender or the debtor-in-possession is the bigger DIP.
most important sentence in the entire guaranty because it describes what ABC is obligated to pay. This definition of Guaranteed Debt includes the Obligation, all interest (whether accruing before or after maturity), and all attorneys' fees and other costs incurred by BigBank in enforcing payment of any of the guaranteed debt. Although interest is included within the definition of Obligation, it seems prudent to emphasize to ABC that its liability is greater than just the principal amount of the $100,000,000 loan. Attorneys' fees are specifically mentioned; otherwise, guarantors are not liable for them under Texas law.

The parenthetical provision pertaining to XYZ's possible bankruptcy is included because section 506(b) of the Bankruptcy Code prevents BigBank from recovering postpetition interest from XYZ unless the value of collateral equals or exceeds the unpaid obligation. If BigBank is undersecured, ABC might argue that it is not liable under the guaranty for postpetition interest because XYZ is not liable for postpetition interest. Also, after a bankruptcy petition is filed, the automatic stay provision of the Bankruptcy Code may bar BigBank from collecting any payments from XYZ until BigBank obtains relief from the stay. ABC might argue that it is not liable under its guaranty for any payments that XYZ cannot make itself while the stay is in effect. The definition of Guaranteed Debt, as well as language in paragraph 8(e) below, that clearly states that ABC's liability under the guaranty is not released, diminished, or impaired if XYZ seeks bankruptcy protection, should successfully rebut ABC's contrary arguments.

EP: The definition of Guaranteed Debt seems transaction-specific; it includes the Obligation and related interest and expenses. Don't many drafters define Guaranteed Debt in a more open-ended manner? For example, I've seen definitions that purportedly covered all debt of every kind and character owed by a borrower to a lender, whether then existing or thereafter arising, including, without limitation, the "Obligation," as that term is

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22. See Blume v. National Homes Corp., 441 S.W.2d 176, 179 (Tex. 1969) ("It is well settled that signers of Guaranty Agreements are not liable for attorney's fees incurred in suits to enforce such guaranty agreements in the absence of an express provision for such liability.").
24. See, e.g., Western Bank-Downtown v. Carline, 757 S.W.2d 111 (Tex. App.—Houston [1st Dist.] 1988, writ denied) (holding guarantor not liable for postpetition interest where lender's claim was undersecured—thus precluding payment of postpetition interest by borrower—and guaranty covered only debt that borrower owed to lender).
26. See United States v. Bruno, 747 F.2d 53 (1st Cir. 1984) (holding guarantor liable for postpetition interest not otherwise payable by borrower where guaranty stated guarantor's liability would not be affected or impaired by borrower's bankruptcy or release by law) (cited with approval in Western Bank, 757 S.W.2d at 114).
defined in a specific agreement, together with interest, attorneys' fees, etc. Wouldn't BigBank prefer the expanded definition?

HC: Probably. Under an expanded definition, ABC is liable not only for all of the debt that falls within paragraph 2's definition of Guaranteed Debt, but also for all other debt that XYZ may then or thereafter owe to BigBank under agreements separate from the credit agreement, such as letters of credit, interest rate contracts, and other loan agreements. Counsel for lenders often adopt the expanded definition of Guaranteed Debt that you have suggested, but I am sympathetic to the response that a guarantor and its counsel will make to that definition.

EP: And Miranda, what would that response be?

MD: A broad definition exposes a guarantor to unlimited liability because it cannot be determined with any degree of comfort what additional debt the borrower may incur and owe to the lender. Under a transaction-specific definition, ABC can estimate its potential exposure at $100,000,000 plus related interest and costs. However, under an open-ended definition, XYZ and BigBank—over ABC's objections—may expand their relationship, the effect of which will increase—perhaps double or triple—ABC's potential liability under its guaranty. I never recommend to my clients that they sign a guaranty that exposes them to such unlimited exposure. Instead, I request a deal-specific definition of Guaranteed Debt such as the one presented above. If the lender and its counsel object to a definition that narrows the scope of exposure, then I insist that the document permit the guarantor to give written notice to the lender that it will not be liable under the guaranty for any debt incurred by the borrower after such notice is given.

HC: And as lender's counsel I'll respond by requesting language that clearly indicates that the guarantor remains liable under its guaranty for the guaranteed debt as it exists when the notice is given, plus all loans made after notice is given if made under commitments or agreements executed by the borrower and the lender prior to the notice. I'll also recommend language indicating that the guarantor remains liable for renewals and extensions of the debt outstanding as of the date of its notice, as well as renewals and extensions of additional debt incurred by the borrower after such notice, but pursuant to commitments and agreements made by the borrower and the lender prior to such notice.27

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27. See First Bank v. Bradley, 702 S.W.2d 683, 685–86 (Tex. App.—Houston [14th Dist.] 1985, no writ) ("Following such a revocation, the guarantor is liable only for extensions of credit before the revocation and any renewals or extensions of the indebtedness he initially guaranteed."); Dicker v. Lomas & Nettleton Fin. Corp., 576 S.W.2d 672, 676 (Tex. Civ. App.—Texarkana 1978, writ ref'd n.r.e.) ("[A] written revocation would be effective only as to loans made subsequent to such notice and not to a renewal of an existing loan.").
MD: At which point I'll suggest language clearly prohibiting liability for any increases upon renewal and extension.

EP: So let's assume that a guaranty includes an open-ended definition of Guaranteed Debt, but also includes the language suggested by each of you. Let's also assume that ABC gives notice of revocation when BigBank has advanced $150,000,000 under two $100,000,000 credit facilities; one facility is fully funded and the other permits XYZ to borrow the remaining $50,000,000. Under a guaranty with your suggested language, ABC remains liable for the outstanding loans of $150,000,000 plus any of the additional $50,000,000 funded thereafter. ABC's liability remains unchanged if at an assumed maturity date of December 31, 1994, XYZ and BigBank extend the maturity for an additional year, as long as they do not increase the original principal of $200,000,000. Correct?

HC and MD (simultaneously): Correct. 28

EP: Then let's move on. Howard, please give us your thoughts on paragraph 3.

3. Absolute, Irrevocable, and Continuing Guaranty. This instrument is an absolute, irrevocable, and continuing guaranty, and the circumstance that at any time or from time to time the Guaranteed Debt may be paid in full does not affect the obligation of Guarantor with respect to the Guaranteed Debt of Borrower thereafter incurred. Notwithstanding any contrary provision in this Guaranty, however, Guarantor's maximum liability hereunder is limited, to the extent, if any, required so that its liability is not subject to avoidance under any Debtor Relief Law.

HC: The first sentence specifically mentions irrevocability because Texas law permits a guarantor to revoke the guaranty unless that right is precluded by language in the guaranty. 29 The first sentence also indicates that the guaranty remains effective even if the guaranteed debt occasionally has a zero balance.

EP: When would that happen?

HC: Assume that the $100,000,000 loan is in the form of a revolving facility that permits XYZ to borrow, repay, and reborrow funds prior to the

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28. Because Howard and Miranda are on national television, they dare not utter what they are both thinking: “Jinx one two three you owe me a Coke.”

29. See Straus-Frank Co., v. Hughes, 156 S.W.2d 519, 520 (Tex. 1941) (“The general rule is that a continuing guaranty may be revoked by the guarantor unless the right to revoke is precluded by the language of the guaranty contract.”); First Bank, 702 S.W.2d at 685 (“[A] guarantor may revoke his guaranty at any time unless that right is precluded by the language of the guaranty contract.”).

The drafting party should qualify or delete any reference to irrevocability if the lender agrees that the guarantor may give notice of revocation.
maturity date. XYZ might request an initial advance of $10,000,000 on January 1, repay it on January 31, and request a second advance of $10,000,000 on March 1. The sentence removes any doubt that ABC is somehow released from liability for the second funding because the guaranteed debt had an interim zero balance during February.

EP: I see. And the second sentence?

HC: The second sentence is included in an effort to minimize the fraudulent transfer hazards under the Texas Uniform Fraudulent Transfer Act\(^\text{30}\) and section 548 of the Bankruptcy Code,\(^\text{31}\) under which a court or bankruptcy trustee may set aside the guaranty if evidence indicates that ABC satisfies one of the articulated financial distress tests and did not receive reasonably equivalent value for its payment obligations under the guaranty.\(^\text{32}\) Even without the language, BigBank’s risk that ABC’s guaranty obligation is a fraudulent transfer is diminished because ABC is the parent of XYZ, the borrower. As we mentioned earlier,\(^\text{33}\) BigBank may successfully argue that ABC received reasonably equivalent value for its payment obligations under the guaranty because all loans made to XYZ


Section 548 of the Bankruptcy Code applies only if the guarantor is bankrupt and the guaranty was executed within one year preceding the date on which the guarantor’s bankruptcy petition was filed. 11 U.S.C. § 548(a) (1988). In contrast, the Texas statute requires the guarantor’s claim to arise before or within a reasonable time after the guaranty was executed. TEX. BUS. & COM. CODE ANN. § 24.005(a) (Vernon 1987 & Supp. 1994). See also id. § 24.010 (indicating that a cause of action for a fraudulent transfer is extinguished unless action is brought within a prescribed time period).


\(^{33}\) See supra note 16 and accompanying text.
indirectly inured to the benefit of ABC through its ownership of XYZ.\(^{34}\)

EP: Howard, couldn’t you minimize the fraudulent transfer hazards by limiting ABC’s liability to a high percentage—for example, ninety-five percent—of its net worth? ABC would retain a sliver of net worth, and therefore its payment obligations under the guaranty would not render it insolvent.

HC: Many attorneys agree with you and draft accordingly. However, a net worth guaranty raises various concerns, at least in my mind. For example, the net worth guaranty may address insolvency problems\(^{35}\) but still be voidable as a fraudulent transfer if the guarantor fails the capitalization or cash flow tests.\(^{36}\) Also, “net worth” is an elusive concept. How do you define it—and as of what day? Furthermore, a net worth guaranty, by definition, requires the lender to leave value on the table for the guarantor’s other creditors. No lender likes to do that. Finally, the theoretically enhanced enforceability of a net worth guaranty against fraudulent conveyance attack has not been judicially scrutinized. Who can guess what percentage of net worth articulated in a guaranty will eventually pass judicial muster? Eighty-five percent? Ninety-nine percent?\(^{37}\) For these reasons, I avoid using a net worth limitation in any guaranty that I draft for a lender.

EP: OK, let’s move on. Miranda, walk us through the fourth paragraph.

4. Payment on Default. If a Default exists, Guarantor shall, on demand and without further notice of dishonor and without any notice having been given to Guarantor previous to such demand of either the acceptance by Lender of this Guaranty or the creation or incurrence of any Guaranteed Debt, pay the amount of the Guaranteed Debt then due and payable to Lender, and it is not necessary for

\(^{34}\) However, the same argument cannot be made if the guarantor is a subsidiary, rather than the parent, of the borrower. In this so-called upstream context, the only value likely to be received by the subsidiary guarantor may be limited to the amount of funds that are borrowed by the parent borrower and downstreamed to the subsidiary guarantor. In an effort to reduce fraudulent transfer exposure, some subsidiary guaranties expressly limit the guarantor’s liability to the borrowed funds that it indirectly receives, together with related interest and costs. The lender that holds such a guaranty must carefully document which corporate entity ultimately receives each loan disbursement, and should require that entity to repay any such loan directly to the lender, rather than direct payments through the borrower—whose failure to forward the loan payments to the lender may trigger a dispute as to the amount of the guarantor’s liability.


Lender, in order to enforce such payment by Guarantor, first or contemporaneously to institute suit or exhaust remedies against Borrower or others liable on such indebtedness or to enforce rights against any collateral securing such indebtedness.

MD: This paragraph requires ABC to pay the guaranteed debt then due and payable upon BigBank's demand—which BigBank cannot make unless a default exists. If the credit agreement permits BigBank to accelerate the maturity of the loan if a default exists, and BigBank has done so, then the guaranteed debt "then due and payable" will be the entire loan, regardless of whether the default is a payment default or a non-payment default, and whether any of the loan was otherwise due and payable when the default occurred. Also, the language at the end of the paragraph prevents ABC from successfully arguing that BigBank cannot demand payment under the guaranty until BigBank first sues XYZ or forecloses on the collateral pledged by any party.  

EP: So in a lawsuit to recover on the guaranty, BigBank must prove that a default exists and it has demanded payment from ABC. Anything else?

MD: BigBank also must establish that it is the present holder of XYZ's note, the beneficiary of a guaranty executed by ABC, and the amount demanded is due and payable. Because the effectiveness of the guaranty is not expressly subject to any other conditions precedent, BigBank need not prove anything else.

38. See Hanks v. NCNB Texas Nat'l Bank, 815 S.W.2d 763 (Tex. App.—Eastland 1991, no writ) (holding that language in guaranty permitted lender to enforce payment by guarantor before suing other liable parties, including maker of notes).


40. For a case in which the court held that a lawsuit against the guarantors was itself sufficient demand—over the objections of the guarantors in reliance on specific language in the guaranty requiring written demand as a condition to payment—see Texas Water Supply Corp. v. Reconstruction Fin. Corp., 204 F.2d 190, 194 (5th Cir. 1953).

41. See Resolution Trust Corp. v. Marshall, 939 F.2d 274, 276 (5th Cir. 1991) ("[To recover from guarantor of note], the RTC had to establish (1) that the note and the guaranty agreement exist and are valid, (2) that the RTC is the present holder or owner of the note, (3) that [the maker] defaulted on the note, and (4) that [the guarantor] is liable under the guaranty agreement."); Sunbelt Sav., FSB v. Birch, 796 F. Supp. 991, 995 (N.D. Tex. 1992) ("Under Texas law, a plaintiff may recover upon a guaranty if he shows (1) that the defendant executed the guaranty, (2) that the underlying note is in default, (3) that the plaintiff is the present holder of the note and guaranty, and (4) that a certain balance is due and owing.").

BigBank's cause of action against ABC is subject to a four-year statute of limitations. See FDIC v. Bledsoe, 989 F.2d 805, 807 (5th Cir. 1993) (citing TEX. CIV. PRAC. & REM. CODE ANN. § 16.004(a)(3) (Vernon 1986)).

42. See, e.g., Eastman Oil Well Survey Co. v. Hamil, 416 S.W.2d 597, 604–05 (Tex. Civ. App.—Houston 1967, writ ref'd n.r.e.) (holding that guarantor could not avoid liability on

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EP: Howard, will ABC's counsel offer any comments on paragraph 4?

HC: Perhaps one. If the guarantor and the borrower are part of the same corporate family—such as ABC and XYZ—ABC's lawyer may request language that (1) requires the lender to notify the guarantor of the default before exercising its rights and remedies, and (2) permits the guarantor to avoid paying the guaranteed debt then due and payable if it cures the default during a short period—for example, five days—after receiving the notice. The lender should not mind waiting a few days before exercising its rights and remedies if during that time the guarantor can remedy the default through either its relationship with the borrower or its own independent actions.

MD: I, too, make a similar request when I represent a guarantor. If I'm representing the lender, I raise the proposed change with my client but don't offer a lot of input, as this is more of a business issue than a legal issue. Some banks don't mind giving a default notice and a short cure period to the guarantor, but others adamantly refuse to do so because such a change either violates bank policy, or runs counter to prevailing market terms. If I represent the lender and the guarantor's request for notice and cure is acceptable to my client, I'll draft language that indicates that the lender is not obligated to give notice—and no cure period exists—if the relevant default is bankruptcy related or otherwise based on a factual situation that cannot be cured by the guarantor, such as a misrepresentation or an unauthorized disposition of collateral.

grounds of (i) conditional delivery when beneficiary had no knowledge of conditions or (ii) failure to receive notice of acceptance when guaranty was not in form of offer or proposal, and neither guarantor's conduct nor guaranty itself suggested guarantor expected or desired notice of acceptance).

43. The "business issue" theory is most often invoked by an attorney to deflect to the client the hate-filled stares, crass gestures, and unkind thoughts of opposing counsel and its client. "I sympathize with you, I really do, and I'm persuaded by your well-reasoned arguments that you have articulated extremely well. But, my client told me to draft the provision this way and, well, it really is a business issue." In some circles, the business issue theory is called "passing the buck" or "doing the Pontius Pilate."

44. The "violates bank policy" and "runs counter to prevailing market terms" arguments are not-so-distant cousins of the business issue theory.

45. As revised, paragraph 4 might read as follows:

Lender shall notify Guarantor in writing of any Default (other than any bankruptcy-related Default or Default under Sections ___ of the Credit Agreement) prior to exercising any remedies under the Loan Papers and Guarantor shall have the right to cure any such Default within five days after receiving any such notice. If, while a Default exists, Borrower fails to pay the entire unpaid balance of the Obligation then due and payable and Guarantor fails to cure such Default within five days after receiving notice of such Default from Lender (other than any bankruptcy-related Default or Default under Sections ___ of the Credit Agreement, to which no such notice and cure period apply), then Guarantor shall, on demand and without further notice of dishonor and
5. Waiver of Subrogation Rights, Etc. Guarantor will not assert, enforce, or otherwise exercise (a) any right of subrogation to any of the rights or liens of Lender or any other beneficiary against Borrower or any other obligor on the Guaranteed Debt or any collateral or other security, or (b) any right of recourse, reimbursement, subrogation, contribution, indemnification, or similar right against Borrower or any other obligor on all or any part of the Guaranteed Debt, and Guarantor irrevocably waives any and all of the foregoing rights (whether such rights arise in equity, under contract, by statute, under common law, or otherwise).

HC: This provision attempts to respond to the mischief created by the infamous Deprizio decision, which effectively held that a bankruptcy trustee could recover from a lender any payment made by the borrower to the lender within one year of the filing date of the borrower's bankruptcy petition if the payment was guaranteed by an insider of the borrower. The court's analysis went something like this: Section 547(b) of the Bankruptcy Code permits a bankruptcy trustee to recover payments made by the bankrupt borrower (1) to or for the benefit of a creditor, (2) for a debt incurred before the payment was made, (3) made while the borrower was insolvent, (4) made on or within ninety days before the date of the filing of the petition or between ninety days and one year before the date of the filing of the petition if such creditor at the time of such transfer was an insider, and (5) that enable the creditor to receive more than the creditor would receive if the case were a chapter seven liquidation case and payments were not made. A guarantor is a "creditor" of the bankrupt borrower because its common law subrogation rights to payment from the borrower that are created when the guarantor makes payment to the lender under its guaranty give it a "claim" recognized by the Bankruptcy Code. Each of the borrower's payments of the debt owed to the lender is "for the benefit of" the guarantor because every reduction in the debt reduces the guarantor's expos

without any notice having been given to Guarantor previous to such demand of either the acceptance by Lender of this Guaranty or the creation or incurrence of any Guaranteed Debt, pay the amount of the Guaranteed Debt then due and payable to Lender, and it is not necessary for Lender, in order to enforce such payment by Guarantor, first or contemporaneously to institute suit or exhaust remedies against Borrower or others liable on such indebtedness or to enforce rights against any collateral securing such indebtedness.

47. A debtor is presumed to be insolvent during the 90-day period preceding the filing date of the bankruptcy petition. 11 U.S.C. § 547(f) (1988).
49. Id. § 101(5)(A) (Supp. IV 1992) (definition of "claim" includes contingent rights to payment) and § 101(10) (definition of "creditor" includes party with claim).
sure under its guaranty. If the guarantor-creditor is an "insider"—which the Bankruptcy Code defines as including a person in control of the borrower, such as its parent corporation—the preference period is extended fourfold from ninety days to one year. And, section 550 of the Bankruptcy Code permits the trustee to recover from the lender—as the "initial transferee"—all of the borrower's payments that benefitted the insider guarantor.

EP: So an innocent noninsider lender who prudently attempts to mitigate its potential loss by requiring a guaranty—which almost always will be executed by an insider—risks quadrupling the preference period during which loan payments received by the lender may later be disgorged upon attack by the trustee?

HC: Yes. The decision has not been favorably received in the financial community and has been the subject of much commentary. And, unfortunately, the Deprizio analysis has been adopted by other federal appellate courts, including the Fifth Circuit, which includes Texas.

EP: And how does the language in paragraph 5 aid the lender?

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50. This assumes that the guarantor has not executed a partial guaranty. Consider the following hypothetical. Borrower executes a promissory note for $1,000,000. The borrower's parent corporation guarantees repayment of only $700,000. When the borrower files its bankruptcy petition, the unpaid principal is $800,000 (with the $200,000 paid more than ninety days before but within one year of the filing date of the petition). If the bankruptcy trustee attempts to recover the $200,000 from the lender, may the lender successfully argue that the parent guarantor never received a benefit from the $200,000 payment (because its exposure under the guaranty did not decrease) and thus the preference period is only 90 days (precluding disgorgement of the $200,000 received outside the 90-day period)? See Travelers Ins. Co. v. Cambridge Meridian Group, Inc. (In re Erin Food Servs., Inc.), 980 F.2d 792, 800–01 (1st Cir. 1992); Cannon Ball Indus., Inc. v. Sequa Corp. (In re Cannon Ball Indus., Inc.), 155 B.R. 177, 179–80 (N.D. Ill. 1993).

51. 11 U.S.C. § 101(31)(B)(iii). Each subsidiary corporation of the borrower that executes a guaranty is also an insider if the borrower directly or indirectly owns at least 20% of the outstanding capital stock of the subsidiary guarantor. Id. § 101(31)(E) (stating insiders includes affiliates) and § 101(2) (1988) (defining "affiliate").

52. 11 U.S.C. § 547(b)(4)(B) (1988). "The one-year preference period is designed to inhibit insiders—entities normally privy to inside financial information long before it becomes available to arm's-length creditors—from influencing the insolvent debtor to deplete its remaining assets for the insider's benefit, to the detriment of non-insider creditors." In re Erin Food Servs., Inc., 980 F.2d at 796.

53. 11 U.S.C. § 550(a)(1) (1988). The trustee may also recover the value of the payments from the guarantor as an "entity for whose benefit such transfer was made . . . ." Id. But as between the lender and the guarantor, guess whose pockets appear deeper to the trustee.


55. See Southmark Corp. v. Southmark Personal Storage, Inc. (In re Southmark Corp.), 993 F.2d 117 (5th Cir. 1993); see also Official Unsecured Creditors Comm. of Sufolla, Inc. v. U. S. Nat'l Bank (In re Sufolla, Inc.), 2 F.3d 977 (9th Cir. 1993); In re Erin Food Servs., Inc., 980 F.2d at 792; Ray v. City Bank & Trust Co. (In re CL Cartage Co.), 899 F.2d 1490 (6th Cir. 1990); Manufacturers Hanover Leasing Corp. v. Lowrey (In re Robinson Bros. Drilling, Inc.), 892 F.2d 850 (10th Cir. 1989).
HC: The waiver attempts to eliminate the risk to the lender that it will be required to disgorge to the trustee all loan payments made by the borrower more than ninety days before, but within one year of, the filing date of the bankruptcy petition. The theory is that if the guarantor waives all of its rights of recourse, subrogation, etc., it is not a creditor because it no longer has a claim. And if the guarantor is not a creditor, loan payments made more than ninety days before the filing date of the bankruptcy petition do not benefit an insider creditor. Absent any benefit to an insider, the preference period is limited to ninety days. Therefore, payments made by the borrower to the lender outside the 90-day preference period are not recoverable from the lender by the trustee.\(^{56}\)

EP: Sounds plausible. Has any court ruled on the enforceability of this waiver?

HC: Yes. To my knowledge, the only two courts that have addressed the enforceability of such a provision have ruled in favor of the lender and against the trustee.\(^{57}\)

EP: Any thoughts from the guarantor’s perspective, Miranda?

MD: Generally, there’s not a lot of room for negotiating the provision.\(^{58}\) However, because the lender is concerned about extending the preference period from ninety days to one year—and such an extension only exists if the guarantor is an insider\(^{59}\)—then, as guarantor’s counsel, I insist on language that makes the waiver applicable only if the guarantor is an “insider” as defined by the Bankruptcy Code. Howard will agree with me that the lender and its counsel should be amenable to the change.

HC: You’re right, Miranda. Usually, when the guaranty is executed, the parties know whether the guarantor falls within the Bankruptcy Code’s

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56. In addition to relying on any waiver language in the guaranty, a lender may be able to rebut the bankruptcy trustee’s preference attack with other arguments. See Levit v. Ingersoll Rand Fin. Corp. (In re V. M. Deprizio Constr.), 874 F.2d 1186, 1198–1200 (7th Cir. 1989).

57. See Hostmann v. First Interstate Bank, N.A. (In re XTI Xonix Tech. Inc.), 156 B.R. 821, 826 (Bankr. D. Or. 1993); Hendon v. Associates Comm. Corp. (In re Fastrans, Inc.), 142 B.R. 241, 245 (Bankr. E.D. Tenn. 1992); see also In re Sufolla, Inc., 2 F.3d 981 (“It reasons that in order to maneuver around Deprizio, and as a condition to the extension of credit, lenders will compel guarantors to waive their rights of reimbursement or indemnification from the debtor. Deprizio arguably is inapplicable in such circumstances because the insider is no longer a ‘creditor.’”) (footnote omitted). But see id. at 986 (“Whether a waiver of the guarantor’s rights against the debtor suffices to circumvent this rule is a question we leave for another panel and another day.”). Cf. Covey v. Northwest Community Bank (In re Helen Gallagher Enters., Inc.), 126 B.R. 997 (Bankr. C.D. Ill. 1991) (suggesting in dicta that waiver might be unenforceable).

58. But for an article that discourages the use of such waiver language, see Peter L. Borowitz, Waiving Subrogation Rights and Conjuring Up Demons in Response to Deprizio, 45 Bus. Law. 2151 (1990) (arguing that waiver language may create fraudulent transfer risk for the lender).

detailed definition of "insider." It's possible, however, that during the life of the guaranty, the relationship between the guarantor and the borrower might change, resulting in an insider becoming a noninsider, or vice versa. Also, any time you deal with a statute you become subject to the vagaries of judicial interpretation.

EP: Miranda, could the contractual relationship between a lender and a borrower render the lender an insider?

MD: I doubt it, unless the lender has the ability to exercise actual managerial control over the borrower or enjoys some special affinity with the borrower that extends beyond a business relationship, whether long-term or otherwise. In my opinion, such control should not be present merely because the lender can exert financial leverage or exercise its rights under the loan documents. However, a court probably would find sufficient control if the lender could unqualifiably dictat corporate policy and the disposition of corporate assets. 61

EP: Now let's turn to the provisions concerning representations, warranties, and covenants of ABC. Miranda, your comments, please.

6. Representations and Warranties. Guarantor acknowledges that certain representations and warranties in the Credit Agreement are applicable to it and confirms that each such representation and warranty is true and correct. [Guarantor also represents and warrants to Lender as follows:]

7. Covenants. Guarantor acknowledges that certain covenants and other provisions in the Credit Agreement are applicable to it or will be imposed upon it and agrees to promptly and properly comply with or be bound by each of them. [In addition, Guarantor further covenants and agrees with Lender as follows:]

MD: Many of the representations, warranties, and covenants in the credit agreement between BigBank and XYZ are applicable to "the Companies," or some similar term that is defined to include XYZ, as borrower, and any of its affiliated companies—including, without limitation, any affiliate that executes a loan paper, such as a guaranty or a collateral document. Whether I represent the lender or the guarantor, my primary task in drafting and negotiating representations, warranties, and covenants in any ancillary

60. For example, an individual guarantor who is a director or officer of a corporate borrower is an insider, as is a corporate parent that owns 100% of the capital stock of the borrower. 11 U.S.C. § 101(31)(B)(i)–(iii) (Supp. IV 1992). However, during the life of the guaranty the individual guarantor might lose his directorship or office, and the corporate parent might sell such a large percentage of the capital stock of the borrower that it no longer controls the debtor. Many times, these and other changes in insider status may trigger a default under the loan papers. For example, the loan papers may include a provision that prohibits a parent guarantor from owning less than a specific percentage of the outstanding capital stock of its subsidiary borrower.

document, such as the guaranty, is to ensure consistency with provisions in the credit agreement. My preference is to include in the guaranty only those representations, warranties, and covenants that address matters not specifically covered by the credit agreement. If the subject matter is already addressed by a provision in the credit agreement and is applicable to the guarantor, then I prefer to rely on incorporation by reference and the guarantor’s acknowledgement thereof, rather than restate all of the provisions verbatim in the guaranty—which can easily double the length of the guaranty.

EP: Howard, tell us about the next paragraph.

8. Actions Not Releases. Guarantor’s obligations under this Guaranty will not be released, diminished, or affected by the occurrence of any one or more of the following events: (a) Lender’s taking or acceptance of any other security or guaranty for any or all of the Guaranteed Debt; (b) any release, surrender, exchange, subordination, impairment, or loss of any collateral securing any or all of the Guaranteed Debt; (c) any full or partial release of the liability of any other obligor on the Guaranteed Debt; (d) the modification of, or waiver of compliance with, any terms of any other Loan Paper; (e) the insolvency, bankruptcy, or lack of corporate or partnership power of any party at any time liable for any or all of the Guaranteed Debt, whether now existing or hereafter occurring; (f) any renewal, extension, or rearrangement of any or all of the Guaranteed Debt or any adjustment, indulgence, forbearance, or compromise that may be granted or given by Lender to any other obligor on the Guaranteed Debt; (g) any neglect, delay, omission, failure, or refusal of Lender to take or prosecute any action in connection with the Guaranteed Debt; (h) any failure of Lender to notify Guarantor of the creation or incurrence of any Guaranteed Debt, any renewal, extension, or assignment of any or all of the Guaranteed Debt, the release of any security, any new agreement between Lender and Borrower, or any other action taken or refrained from being taken by Lender against Borrower, it being understood that Lender is not required to give Guarantor any notice of any kind under any circumstances whatsoever with respect to or in connection with the Guaranteed Debt, other than any notice required to be given to Guarantor elsewhere in this Guaranty; (i) the unenforceability of any part of the Guaranteed Debt against any party because it exceeds the amount permitted by law, the act of creating it

62. Examples might include a guarantor’s covenant to maintain certain financial covenants or deliver certain financial statements different from, and in addition to, the financial covenants to be maintained or financial statements to be delivered by the borrower.

63. Examples of provisions in a credit agreement that are applicable to a guarantor often include representations, warranties, and covenants concerning the guarantor’s (i) existence, good standing, and authority to transact business as a foreign corporation, (ii) debt and liens, (iii) litigation matters, (iv) corporate authorization to execute and deliver the guaranty, and (v) compliance with laws, including environmental laws and ERISA (an acronym for “Elvis Really Is Still Alive”).
is ultra vires, the officers creating it exceeded their authority or violated their fiduciary duties in connection therewith, or otherwise; or (j) any payment of the Obligation to Lender is held to constitute a preference under any Debtor Relief Law or for any other reason Lender is required to refund such payment or make payment to someone else (and in each such instance this Guaranty will be reinstated in an amount equal to such payment).  

HC: Some variation of this paragraph is included in almost every guaranty for the purpose of preventing the guarantor from asserting defenses to liability if certain events occur, such as those listed. Under Texas law, a guaranty is strictly construed, and any ambiguity or uncertainty is resolved in favor of the guarantor and against the lender. To prevent any ambiguity and uncertainty, this provision expressly states that the guarantor is not released from liability if any of the specified events occur. Numerous cases illustrate that a guarantor’s continued liability following certain acts by the lender or the borrower often hinges on the presence or absence of express language in the guaranty.

EP: Miranda, any thoughts on this paragraph?

64. If the guaranty provides for a cure period under paragraph 4, lender’s counsel should add some form of the following to the end of this paragraph:

or (k) the exercise by Lender of any rights or remedies under the Credit Agreement in violation of Paragraph 4 of this Guaranty.

65. See supra note 12 and accompanying text.

66. See, e.g., United States v. Vahlco Corp., 800 F.2d 462, 465–66 (5th Cir. 1986) (ruling that guarantor could attempt to avoid liability on grounds that lender extended maturity and impaired collateral, unless guaranty contained waiver of those defenses); United States v. Little Joe Trawlers, Inc., 776 F.2d 1249, 1254 (5th Cir. 1985) (concluding that even if Texas law required creditor to give guarantor notice to accelerate debt, creditor’s failure to give such notice did not release guarantor from liability where guaranty expressly provided that guarantor’s obligations would remain alive even if guarantor might be released from performance by operation of law); Vastine v. Bank of Dallas, 808 S.W.2d 463, 464–65 (Tex. 1991) (holding that guarantor could assert defense of material alteration of underlying contract in absence of language in guaranty permitting creditor and principal debtor to change contract without guarantor’s consent); Chambers v. NCNB Texas Nat’l Bank, 841 S.W.2d 132, 134–35 (Tex. App.—Houston [14th Dist.] 1992, no writ) (holding that guarantor remained liable for debt incurred by partnership after incorporation because guaranty stated that change in status of debtor by “merger, consolidation or otherwise” would not alter guarantor’s liability); Simpson v. MBank Dallas, N.A., 724 S.W.2d 102, 106 (Tex. App.—Dallas 1987, writ ref’d n.r.e.) (concluding that guarantor could not avoid liability on theory that lender had impaired collateral without his consent because guaranty expressly permitted lender, at its discretion, to surrender, release, exchange, or alter any collateral without affecting guarantor’s liability); Hernandez v. Bexar County Nat’l Bank, 710 S.W.2d 684, 688–89 (Tex. App.—Corpus Christi 1986, writ ref’d n.r.e.) (ruling that guarantor was not discharged from liability under guaranty on theory that he did not consent to renewal of notes where guaranty expressly permitted lender to create, renew, extend, or alter the guaranteed debt without notice to guarantor); Lawyers Title Ins. Corp. v. Northeast Texas Dev. Co., 635 S.W.2d 897, 899 (Tex. App.—Tyler 1982, writ ref’d n.r.e.) (holding that release of deed of trust did not discharge guarantors from liability where guaranty stated that liability would not be affected, modified, or diminished by release of collateral); Brazosport Bank v. Travis, 617 S.W.2d 729, 731 (Tex. Civ. App.—Houston [14th Dist.] 1981, writ ref’d n.r.e.) (stating that guarantor’s liability survived
MD: Not, as guarantor's counsel. But I do have two comments from the perspective of lender's counsel. First, a guarantor falls within the Uniform Commercial Code Article 9 definition of "debtor," and thus generally cannot waive its right to notice of sale or disposition of collateral under section 9.504(c) prior to default on the guaranteed debt—regardless of any contrary waiver provisions in the guaranty, including clause (h) above. Therefore, unless a guarantor waives after default its right to receive notice of any sale or other disposition of collateral, a lender's failure to give such notice to the guarantor will prevent the lender from recovering any deficiency judgment against the guarantor. Second, a lender should never rely on waiver language in a guaranty or any other loan document as an excuse for ignoring pleading and proof requirements. For example, the Texas Supreme Court has held that a lender's failure to raise as an affirmative defense a guarantor's express waiver of the defense of collateral impairment reduced the guarantor's liability by the extent of the collateral impairment.

EP: While we're on the subject of waivers, I'll ask Miranda to comment on paragraph 9.

9. Waiver of Procedural Rights. Guarantor waives all of its rights by which it might be entitled to require suit on an accrued right of action on any of the Guaranteed Debt or against Borrower or others, whether arising under section 34.02 of the Texas Business and Commerce Code, as amended, section 17.001 of the Texas Civil
Practice and Remedies Code, as amended, Rule 31 of the Texas Rules of Civil Procedure, as amended, or otherwise.

MD: Section 34.02 of the Texas Business and Commerce Code discharges a guarantor's liability if the guarantor requests the lender to sue on the guaranty and the lender fails to do so within a specified period of time or fails to prosecute the suit to judgment and thereafter execute on the judgment.\(^{71}\) Section 17.001 of the Texas Civil Practice and Remedies Code permits a lender to sue a guarantor without suing the borrower, but it precludes entry of judgment against the guarantor prior to entry of judgment against the borrower.\(^{72}\) Rule 31 of the Texas Rules of Civil Procedure requires the lender to join the borrower in any suit against the guarantor unless judgment has been previously entered against the borrower.\(^{73}\) Because the referenced statutes and rule give ABC some rights that limit BigBank's ability to recover the guaranteed debt from ABC, paragraph 9 requires ABC to waive those rights.

EP: Will a Texas court enforce a guarantor's waiver of its rights under these statutes and rule?

MD: Yes, because the rights being waived are intended solely for the benefit of the guarantor and do not confer benefits on any third party.\(^{74}\)

EP: Howard, what about paragraph 10?

10. _Subordination_. All obligations of Borrower to Guarantor (the "Subordinated Debt") are expressly subordinated to the full and final payment of the Guaranteed Debt. Guarantor agrees not to accept any payment of the Subordinated Debt from Borrower if a Default exists. Guarantor will hold in trust for Lender and promptly turn over to Lender (with any necessary endorsements) for application against the Guaranteed Debt any payment of the Subordinated Debt that Guarantor receives in violation of this paragraph.

HC: A default suggests that XYZ may be having financial difficulty and will not be able to timely pay all of its creditors, including BigBank. ABC may also be a creditor of XYZ, either as a result of making permitted intercorporate loans to XYZ, providing centralized management services to XYZ, or otherwise. BigBank wants to be protected against the possibility

\(^{71}\) TEX. BUS. & COM. CODE ANN. § 34.02(a), (b) (Vernon 1987).

\(^{72}\) TEX. CIV. PRAC. & REM. CODE ANN. § 17.001(a), (b) (Vernon 1986).

\(^{73}\) TEX. R. CIV. P. 31.

\(^{74}\) See Yandell v. Tarrant State Bank, 538 S.W.2d 684, 687–88 (Tex. Civ. App.—Fort Worth 1976, writ ref’d n.r.e.) (examining waiver of rights under TEX. R. CIV. P. 31 and precursor to TEX. CIV. PRAC. & REM. CODE § 17.001); see also Hanks v. NCNB Texas Nat'l Bank, 815 S.W.2d 763, 764 (Tex. App.—Eastland 1991, no writ) (addressing waiver of rights under TEX. BUS. & COM. CODE § 34.02); Ford v. Darwin, 767 S.W.2d 851, 855 (Tex. App.—Dallas 1989, writ denied) (examining waiver of rights under TEX. R. CIV. P. 31 and TEX. CIV. PRAC. & REM. CODE § 17.001(b)); Hernandez v. Bexar County Nat'l Bank, 710 S.W.2d 684, 689 (Tex. App.—Corpus Christi 1986, writ ref'd n.r.e.).
that XYZ may favor ABC over BigBank if XYZ is in a cash-poor position. This paragraph gives BigBank protection against that likelihood by requiring ABC not only to subordinate its debt to BigBank's debt, but also to surrender to BigBank any and all debt payments made by XYZ to ABC while a default exists.

MD: It's possible that BigBank may require XYZ's subsidiaries and non-affiliated third parties to execute a detailed subordination agreement. If ABC is also a party to that agreement, then ABC's counsel should request BigBank's counsel to delete the subordination paragraph from the guaranty and instead rely on the separate subordination agreement.

EP: What about this next paragraph, Miranda?

11. Guarantor's Due Diligence. Guarantor confirms that it has executed and delivered this Guaranty after reviewing the terms and conditions of the Loan Papers and all other information that it has deemed appropriate in order to make its own credit analysis and decision to execute and deliver this Guaranty. Guarantor confirms that it has independently investigated Borrower's creditworthiness and is not executing and delivering this Guaranty in reliance on any representation or warranty by Lender as to such creditworthiness. Guarantor expressly assumes all responsibilities to remain informed of Borrower's financial condition and any circumstances affecting (a) Borrower's ability to perform its obligations under the Loan Papers to which it is a party or (b) any collateral securing all or any part of the Guaranteed Debt.

MD: BigBank will enter into a credit relationship with XYZ only after conducting the necessary due diligence and satisfying itself that XYZ is a creditworthy customer. BigBank does not intend for any third party—including ABC—to be the beneficiary of its due diligence. Nor does BigBank want to suggest to any third-party obligor—including ABC—that BigBank alone has the sole responsibility to monitor the credit and the attendant risks until the loan is fully paid. This paragraph requires ABC to attest that it has conducted its own due diligence, is familiar with the terms of the credit documents, and will assume responsibility for keeping itself informed of XYZ's financial condition during the life of the loan. Furthermore, absent egregious conduct by BigBank, ABC's confirmation that it is not relying on anything that BigBank has said or done should estop ABC from successfully arguing that the guaranty is unenforceable on any theory that BigBank fraudulently induced ABC to execute the guaranty.75

75. See Motorola, Inc. v. Chapman, 761 F. Supp. 458, 462–63 (S.D. Tex. 1991) (holding that to prove fraud in inducement sufficient to allow exception to parol evidence rule, guarantor must prove trickery, artifice, or device in addition to misrepresentation); Town North Nat'l Bank v. Broaddus, 569 S.W.2d 489 (Tex. 1978) (reviewing Texas caselaw addressing whether parol evidence rule prohibits admission of extrinsic evidence to prove maker was induced by payee's
EP: And your thoughts, Howard, on paragraph 12.

12. No Defenses; Reinstatement. The Guaranteed Debt will not be reduced, discharged, or released by any existing or future offset, claim, or defense (except for the defense of complete, final, and irrevocable payment of the Guaranteed Debt) of Borrower or any other party against Lender or against payment of the Guaranteed Debt, whether such offset, claim, or defense arises in connection with the Guaranteed Debt or otherwise. Guarantor agrees that if any payment of the Guaranteed Debt is held to constitute a preference under any Debtor Relief Law or for any other reason Lender is required to refund any such payment or make payment to someone else, this Guaranty will continue to remain effective and Guarantor's obligations under this Guaranty will be reinstated in an amount equal to such payment.

HC: When BigBank demands payment from ABC following a default, the only acceptable defense for non-payment is that BigBank has received full and final payment of the guaranteed debt and has not been required to disgorge any payment received. ABC cannot avoid payment liability by raising personal defenses of XYZ, such as failure of consideration, breach of warranty, statute of limitations, usury, mistake, impossibility, and unconscionability.

EP: You specifically mention the defenses of usury and statute of limitations. I thought that a guarantor of a usurious obligation was discharged from liability because the usurious obligation was void. And I would have guessed that a guarantor could avoid liability if the statute of limitations barred collection from the borrower.

HC: Texas cases suggest otherwise, holding that (1) a valid usury claim does not render the underlying obligation void,\(^7\) (2) a guarantor cannot avoid liability on a usurious obligation unless the guaranty itself provides for usurious interest,\(^7\) and (3) a lender may maintain an action

misrepresentation to execute promissory note); Simpson v. MBank Dallas, N.A., 724 S.W.2d 102, 108 (Tex. App.—Dallas, 1987, writ ref'd n.r.e.); see also Rosas v. United States Small Bus. Admin., 964 F.2d 351, 355–56 (5th Cir. 1992) (citing Town North Nat'l Bank and Simpson).


77. See FSLIC v. Griffin, 935 F.2d 691, 701 (5th Cir. 1991), cert. denied, 112 S. Ct. 1163 (1992) (“When the Texas Supreme Court has used the term ‘void’ in connection with usury, they seem to imply only that the usurious interest is void. The Texas courts have not held that underlying obligation itself is void for illegality.”); Houston Sash and Door Co. v. Heaner, 577 S.W.2d 217, 222 (Tex. 1979) (“The usury statute, furthermore, does not declare the underlying open account transaction void, but merely provides Bedford a defensive setoff. It is only where the underlying obligation is void for illegality that a guaranty must fall with it.”) (citations omitted).

78. See Houston Sash and Door Co., 577 S.W.2d at 221–22 (reducing guarantor's liability by appropriate usury penalty triggered by language in guaranty); Moore v. White Motor Credit Corp., 708 S.W.2d 465, 472 (Tex. App.—Dallas 1985, writ ref'd n.r.e.) (“The guarantor of a note usurious as to the borrower, but whose individual contract with the lender does not provide for
against a guarantor even if the statute of limitations bars the lender's claim against the borrower.79

EP: Well, I learned something new today. It looks as if we have two paragraphs left to discuss. Since both of them are relatively short, let's examine them together. Miranda, your thoughts, please.

13. Successors and Assigns. This Guaranty benefits Lender and its successors and permitted assigns and binds Guarantor and its successors and permitted assigns. Guarantor acknowledges that the rights and benefits of this Guaranty may be transferred with any permitted assignment of the Guaranteed Debt.

14. Miscellaneous. This Guaranty is a Loan Paper and is subject to the applicable provisions of Section ['miscellaneous'] of the Credit Agreement, all of which are incorporated into this Guaranty by reference the same as if restated verbatim in this Guaranty.

MD: Paragraph 13 merely indicates that the benefits and burdens of the guaranty flow to BigBank's and ABC's respective successors and permitted assigns, including—in the case of BigBank—any assignee of the guaranteed debt. The word "permitted" is inserted because the credit agreement often limits BigBank's and ABC's ability to assign its respective interest in the loan papers to a third party.80 The purpose of paragraph 14 is to save the drafting party the trouble of retyping provisions found in the credit agreement that address such matters as amendments and waivers, governing law, waiver of jury trial, jurisdiction submission, venue, counterparts, usury savings, number and gender of words, communications, oral agreements, etc. ABC should be bound by such provisions, even if not restated in the guaranty, because in paragraph 11 ABC confirms that it has reviewed the terms of the loan papers, and in paragraph 7, ABC acknowledges that certain provisions in the credit agreement are applicable to it, or will be imposed upon it, and agrees to promptly and properly comply with or be bound by each of them.81 If the drafting party elects to include in the guaranty some or all of the applicable miscellaneous provisions in the credit

79. See Beddall v. Reader's Wholesale Distribs., Inc., 408 S.W.2d 237, 240 (Tex. Civ. App.—Houston 1966, no writ) ("While there is some authority to the contrary, the great weight of authority is that an action to recover on a contract of guaranty cannot be defended by showing that the claim against the original debtor has been barred by the statute of limitations.").

80. The credit agreement usually prohibits the guarantor from assigning or transferring any of its rights, duties, and obligations under the guaranty. The credit agreement may place some limits on a lender's ability to assign or transfer all or part of its rights, duties, and obligations under the loan papers. A common limitation requires the lender's assignee or transferee to be a financial institution.

81. For a case in which the court determined a guarantor's liability by relying on a separate
agreement out of an abundance of caution, he or she should do so in a manner that avoids any conflict between the two documents.

HC: Let me make a comment as ABC's counsel. If the proposed guaranty contains a waiver provision in response to Deprizio similar to paragraph 5, ABC's counsel should consider asking the drafting party to add the following language to paragraph 13:

This Guaranty is for the sole benefit of Lender and its successors and permitted assigns, and none of the provisions herein (including, without limitation, the provisions of Paragraph 5) shall inure to the benefit of any other person or entity (including, without limitation, Borrower); consequently, no other person or entity (including, without limitation, Borrower) shall be entitled to rely upon, or to raise as a defense, in any manner the provisions herein.

The purpose of asking for the additional language is to somehow preserve the waived rights against XYZ. It may or may not accomplish the desired purpose, but there's no harm to ABC in asking for the language. However, BigBank's counsel may argue that the proposed language undercuts the enforceability of the waiver, and thus cannot be included. I'm sympathetic to that argument and would concede the point if confronted with it.82

EP: We have a few minutes left on today's show, so let's take some questions from our audience. Yes, sir, you in the back.

MAN IN THE BACK: Does a lender owe any duty of good faith and fair dealing to a guarantor, particularly since section 1.203 of the Uniform Commercial Code83 imposes an obligation of good faith into every contract?84 Or may such a duty be waived by agreement?

MD: First, section 1.102(c) of the UCC prevents a party from waiving any duty of good faith imposed by section 1.203.85 However, section 1.203 only imposes the duty of good faith on a party to a contract governed by the UCC.86 The only chapter of the UCC that might govern the guaranty document's provisions incorporated by reference into the guaranty, see Brazosport Bank v. Travis, 617 S.W.2d 729, 731 (Tex. Civ. App.—Houston [14th Dist.] 1981, writ ref'd n.r.e.).

82. For two cases with opposing views on whether the trustee in bankruptcy can challenge the enforceability of a waiver provision similar to paragraph 5, see Hostmann v. First Interstate Bank, N.A. (In re XTI Xonix Tech. Inc.), 156 B.R. 821 (Bankr. D. Or. 1993) (ruling that trustee may raise enforceability of waiver); Hendon v. Associates Comm. Corp. (In re Fastrans, Inc.), 142 B.R. 241 (Bankr. E.D. Tenn. 1992) (holding that trustee may not raise enforceability of waiver).

83. There is always at least one inquiring mind who enjoys showcasing his or her intelligence by citing specific statutes or cases. And this person just happens to be sitting in the back of the room—so he can impress everyone.

84. TEX. BUS. & COM. CODE ANN. § 1.203 (Tex. UCC) (Vernon 1968).

85. Id. § 1.102(c) ("The effect of provisions of this title may be varied by agreement ... except that the obligations of good faith ... may not be disclaimed by agreement ... ").

86. Id. § 1.203 ("Every contract ... within this title imposes an obligation of good faith in its performance or enforcement.") (emphasis added).
in our transaction is chapter three, entitled “Commercial Paper.” I suppose ABC might argue that it has executed a guaranty and that section 3.416 pertains to contracts of a guarantor, the guaranty thus is subject to a provision of the UCC, and therefore section 1.203 imposes a duty of good faith on BigBank. This argument has been raised before and usually fails—as it would here—because the guaranty and the promissory note are separate documents, which precludes application of section 3.416. Unless some other provision of the UCC applies to the guaranty, no duty of good faith is imposed by section 1.203.

EP: But doesn’t the common law—separate and apart from the UCC—impose a duty of good faith and fair dealing on a lender when dealing with a borrower and a guarantor?

MD: I’m afraid not. Absent express contractual language that estab-

87. Id. § 3.416.
88. See FDIC v. Nobles, 901 F.2d 477, 480 (5th Cir. 1990) (“[W]e do not believe that the guaranty is governed by the UCC. The guaranty in this case is separate and apart from the promissory note. A guaranty that is a separate document is not considered a negotiable instrument and does not fall within the scope of the UCC.”); Uniwest Mortgage Co. v. Dadecor Condominiums, Inc., 877 F.2d 431, 435 (5th Cir. 1989) (concluding that the enforceability of a choice-of-law provision in a guaranty was governed by common law and not UCC); T. O. Stanley Boot Co. v. Bank of El Paso, 847 S.W.2d 218, 223 (Tex. 1992) (holding that guaranties were not negotiable instruments); FDIC v. Coleman, 795 S.W.2d 706, 710 (Tex. 1990).

Even if the guaranty provisions were added to the bottom of the promissory note and signed by the guarantor, § 3.416 would apply only if the promissory note itself was a negotiable instrument. See TEX. BUS. & COM. CODE ANN. § 3.416 (Tex. UCC) (Vernon 1968) (making numerous references throughout to “instrument,” which § 3.102(a)(5) defines as a “negotiable instrument”). In many large commercial transactions, the promissory note is no more than one page in length with only a few paragraphs, one of which is often a variation of the following:

This note incorporates by reference the principal and interest payment terms in the Credit Agreement for this note. This note also incorporates by reference all other provisions in the Credit Agreement applicable to this note—such as provisions for disbursements of principal, applicable interest rates before and after default, voluntary and mandatory prepayments, acceleration of maturity, exercise of rights and remedies, payment of attorneys’ fees, court costs, and other costs of collection, certain waivers by maker and other obligors, assurances and security, choice of Texas and United States federal law, usury savings, and other matters applicable to “Loan Papers” as defined in the Credit Agreement.

This paragraph might render the promissory note nonnegotiable. See TEX. BUS. & COM. CODE ANN. § 3.104(a) (Tex. UCC) (Vernon 1968) (“Any writing to be a negotiable instrument within this chapter must . . . (2) contain an unconditional promise or order to pay . . . .”); id. § 3.105(a) (“A promise or order otherwise unconditional is not made conditional by the fact that the instrument . . . (3) refers to or states that it arises out of a separate agreement or refers to a separate agreement for rights as to prepayment or acceleration . . . .”); id. § 3.105(b) (“A promise or order is not unconditional if the instrument (1) states that it is subject to or governed by any other agreement . . . .”).

89. If the guaranty provisions are part of either a contract for the sale of goods or a security agreement, then Article 2 (Sales) or Article 9 (Secured Transactions; Sales of Accounts and Chattel Paper) might apply. However, in most transactions—and in the hypothetical transaction in this article—the guaranty is a stand-alone document.
lishes the duty of good faith and fair dealing, Texas courts have consistently refused to impose the duty unless the evidence indicated that a special relationship of trust and confidence existed between the parties, either as a recognized fiduciary relationship, or a relationship arising from moral, social, or personal relationships. However, I'm not aware of any Texas case that has found such a relationship between a lender and its borrower or guarantor.  

EP: Another question? Yes, ma'am.

MA'AM: In many lending transactions, all of the borrower's subsidiaries act as guarantors. If the credit agreement requires the borrower to cause its future subsidiaries to execute a guaranty, will a failure of consideration problem exist since any such guaranty is not executed contemporaneously with the other loan papers?

HC: As we mentioned earlier in the show, a guaranty executed after related loan papers have been executed may not be enforceable for lack of new consideration. However, some cases from other jurisdictions have held that new consideration is not required to support a guaranty executed subsequent to the principal contract if the guaranty is executed pursuant to a prior understanding and was an inducement to the execution of the principal contract. A Texas court following this line of cases might enforce a guar-

90. See Coleman, 795 S.W.2d at 708–09 ("The Court has consistently held, however, that a duty of good faith is not imposed in every contract but only in special relationships marked by shared trust or an imbalance in bargaining power. . . . [T]he relationship between a creditor and [a] guarantor does not ordinarily import a duty of good faith."); SEI Business Sys., Inc. v. Bank One Texas, N.A., 803 S.W.2d 838, 840 (Tex. App.—Dallas 1991, no writ) ("A secured creditor owes no duty of good faith to a guarantor."); Nautical Landings Marina, Inc. v. First Nat'l Bank, 791 S.W.2d 293, 299 (Tex. App.—Corpus Christi 1990, writ denied) ("We have been cited no authority and have found none in Texas which imposes a duty of good faith and fair dealing on lenders in general to their borrowers."). But see RESTATEMENT (SECOND) OF CONTRACTS § 205 (1981) ("Every contract imposes upon each party a duty of good faith and fair dealing in its performance and its enforcement.").

91. See supra note 17 and accompanying text.

92. See United States v. Lowell, 557 F.2d 70, 72 (6th Cir. 1977); First Nat'l Bank v. International Mach. Corp., 156 N.W.2d 86, 88 (Minn. 1968); Spittler v. Nicola, 479 N.W.2d 803, 807–08 (Neb. 1992) ("[I]f a guaranty promise was made at a time subsequent to the creation of the principal obligation, the guaranty promise is still founded upon a consideration if the promise was given as the result of a previous arrangement, the principal obligation having been induced or created on the faith of the guaranty."); State Bank v. Porter, 167 N.W.2d 527, 531 (N.D. 1969) ("A guaranty, although executed subsequently to the creation of the principal obligation, if given in fulfillment of an agreement on the faith of which the principal obligation was created, is deemed contemporaneous in effect and requires no other consideration."); see also 38 AM. JUR. 2D Guaranty § 45 (1968) ("Although the guaranty promise may have been made at a time subsequent to the creation of the principal obligation, the guaranty promise is founded upon a consideration if the promise was given as the result of previous arrangement, the principal obligation having been induced by or created on the faith of the guaranty.") (footnote omitted); 38 C.J.S. Guaranty § 26(b) (1943) (No new consideration required to support subsequent guaranty "executed pursuant
anty executed by a future subsidiary if the guaranty was executed pursuant
to a covenant requirement in the credit agreement, and the covenant induced
the lender to enter into a credit relationship with the borrower. Also,
lender's counsel would be prudent to mention in the recitals to the guaranty
that the guarantor is a new subsidiary of the borrower and is executing the
 guaranty as required by the specific covenant in the credit agreement. Per-
haps Miranda has some additional thoughts.

MD: I would argue that the subsequent guaranty is supported by new
consideration. If the borrower fails to cause the new subsidiary to execute a
guaranty, a covenant will be breached and a default will exist, which will
permit the lender to exercise various rights and remedies. However, the
lender will forbear exercising its rights and remedies if the borrower causes
its future subsidiary to execute and deliver a guaranty. In my opinion, the
lender's forbearance constitutes new consideration that supports the subse-
quent guaranty.

EP: Sir, you have a question?
SIR: No, I was just adjusting my toupee.

EP: Oh. Excuse me. Another question for our panelists? Yes, the
gentleman over there.

GENTLEMAN OVER THERE: While we're on the subject of consid-
eration, do either of the panelists have any thoughts on including such
words as "for valuable consideration, the receipt and adequacy of which are
acknowledged" or reciting the guarantor's receipt of a nominal amount—
perhaps $10?

MD: I don't have strong feelings on either excluding or including
your suggested language. However, it seems somewhat unnecessary to
mention valuable consideration in a general sense if the guaranty includes
some variation of recital C, which describes specific consideration. Also,
why would a guarantor acknowledge the receipt and adequacy of the con-
sideration when the benefits often flow to another party, the borrower? Fi-
nally, although I have seen numerous documents that referenced nominal
consideration—such as $10—I have no personal knowledge that the money
truly changed hands. I sense that in most, if not all, cases the drafting party
mentioned a nominal amount as a formality or pretense, never expecting
actual payment to occur. Query whether a recital of nominal payment gives
a guarantor an escape clause from the guaranty if the lender never pays the
nominal amount.93

93. For a case that gives short shrift to such an argument, see Beltran v. Groos Bank, N.A.,
755 S.W.2d 944 (Tex. App.—San Antonio 1988, no writ) (enforcing payment obligations of a
EP: Time for one more question. How about the lady in the third row.

LADY IN THIRD ROW: I understand that Congress is considering amendments to the Bankruptcy Code that would moot the concerns caused by Deprizio. What are your thoughts?

HC: If "pro" is the opposite of "con," then what's the opposite of "progress"?

MD: And I believe Mark Twain once said, "Suppose you were an idiot and suppose you were a member of Congress. But I repeat myself."

EP: On those witty notes we will conclude today's show. Please join me next week when we'll meet a litigator who legitimately billed a client for thirty-seven hours of work in a twenty-four-hour period. And in two weeks, my guest will be a federal appellate judge who writes his own opinions. So long, everybody.

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94. Kenneth H. Bacon, Senate Passes Bill to Amend Bankruptcy Law, WALL ST. J., Apr. 22, 1994, at A2 ("The bill [to amend the 1978 Bankruptcy Code] also reverses a court decision that has discouraged banks from lending to many small businesses. That decision forced lenders to return all loan payments made in the year before a company filed under the Bankruptcy Code, if the company's insiders had personally guaranteed the loan."). The proposed bill amends § 550 of the Bankruptcy Code by preventing a bankruptcy trustee from recovering loan payments from a lender that are guaranteed by an insider unless the lender also is an insider. See 139 CONG. REC. S2,619 (daily ed. Mar. 10, 1993). As of the publication date of this article, the House of Representatives had not yet passed a companion bill.

95. Byrne, supra note 9, at 111.