Guaranties and Waivers in Financial Transactions:

The Particulars of the "Fine Print" Matter a Great Deal in New York

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In today's commercial borrowing climate, very few financial transactions are consummated without the borrower's indebtedness to the lender being guaranteed by at least one other person or entity. Ordinarily in commercial transactions, particularly those in which the borrower is a closely held entity, the borrower's indebtedness is guaranteed by all principals of the borrower and related organizations controlled by the borrower or its principals.[1] In instances where there is more than a single guarantor, each guarantor is ordinarily jointly and severally liable to the lender for the entirety of the underlying obligation.

Although there are many varieties of guaranties, including those limited in amount or duration, those triggered only by the occurrence or non-occurrence of specified events, and those requiring the lender to proceed first against either its collateral for the loan or the principal obligor; the form of guaranty most often required by lenders is the "unconditional" or "absolute" guaranty. This form of guaranty affords the lender the greatest protection and is in most states the simplest type to enforce and the most difficult for a guarantor to seriously challenge or contest. This is particularly true in New York State where a carefully crafted unconditional guaranty may also contain waivers by the guarantor(s) of nearly all potential defenses, counterclaims and offsets, except those made expressly non-waivable by concrete statutory or constitutional provision.

As a financial epicenter, it should surprise no one that New York State has a well developed wealth of case authority addressing the legal effect to be given to unconditional guaranties, nor that such guaranties are generally construed favorably to lenders. What is often misapprehended or not fully appreciated is the profound effect that a carefully drafted comprehensive unconditional guaranty containing express waivers may have upon subsequent collection activities or litigation, even where the circumstances resulting in the litigation fall well beyond what the parties may reasonably be thought to have contemplated at the time the transaction was consummated. The impact that such waivers may have upon later disagreements among the lender, borrower and guarantor(s) are frequently not fully grasped even by sophisticated business persons asked to guaranty commercial debt. Perhaps more surprisingly, lenders (particularly those extending credit in multiple states) not infrequently neglect to tailor their guaranty forms to take full advantage of the favorable judicial treatment afforded to express waiver clauses by New York courts which would allow them to gain maximum protection and considerably ease the collection process should later default or disputes arise.

Although it is said that New York law requires a court to "protect the surety against a liability which is not strictly within the terms of the [guaranty] contract", this standard also requires that the obligations undertaken by the guarantor be strictly applied and enforced.[2]

Where a guaranty is clear and unambiguous and states that it is "absolute and unconditional", guarantors are often precluded from raising a broad range of defenses otherwise available under New York law.[3] Moreover, where the guarantor's obligations are broadly defined as "unconditional and irrevocable, irrespective of . . . any other circumstance which might otherwise constitute a legal or equitable discharge [or] defense", this language has been held to constitute an effective waiver of "all legal or equitable defenses". [4] In addition, under New York law a guarantor's liability is a separate undertaking that may be broader than and contain responsibilities which exceed the scope of those imposed upon the principal obligor.[5] Thus, for example, a guarantor may not only be precluded from litigating defenses that it expressly waived in the guaranty agreement, but may consent through provisions contained in the guaranty document to remain liable for the indebtedness even after the release of a principal borrower, or modification of the underlying loan.[6] Beyond the express provisions of any guaranty waivers, an unconditional guarantor who has executed a comprehensive waiver ordinarily has no standing to assert any defenses or counterclaims of the principal obligor; such defenses or counterclaims being considered "irrelevant" since the guaranty is not dependent upon any condition other than payment. [7] An unconditional guaranty may also qualify for expedited summary disposition pursuant to NYCPLR §3213 as an "instrument for the payment of money only".[8]

While the use of the words "absolute" and "unconditional" alone will not ipso facto constitute a waiver of substantially all defenses, counterclaims and offsets of the guarantor, this language in combination with language which waives "any other circumstance which might otherwise constitute a defense . . . or a discharge of borrower or a guarantor, or providing that all defenses and counterclaims are waived except . . . payment" has been repeatedly enforced to defeat as a matter of law assertions embraced by the waiver language.[9] New York courts have, in fact, consistently held that such language precludes even the right to plead defenses and counterclaims in contravention of the waiver language.[10]

In several instances New York appellate courts have referred to comprehensive waiver clauses contained in unconditional guaranties as an "insurmountable obstacle"[11] to the assertion of defenses and counterclaims by a guarantor. Broad waiver clauses have been strictly enforced to preclude the assertion of a surprising number of defenses and counterclaims that many lawyers would consider elementary rights intrinsic to financing transactions. Some particularly notable examples of claims precluded by waivers include, fraud in the inducement[12], bad faith, unclean hands, equitable estoppel, waiver, failure to mitigate damages and interference or prevention of the borrower's ability to satisfy the loan[13]; release of collateral security or the impairment by the lender of the lender's collateral[14]; forgery and duress[15]; frustration of the borrowers performance of the loan and breach of the implied covenant of good faith and fair dealing[16]; statute of limitation and laches[17]; and discharge, release and failure of consideration.[18]

To be sure, the results in all reported cases do not universally reflect formulaic application of the absolute language contained in some of the appellate decisions referred to in this Article. Fact specific distinctions leading to divergence from the baseline principles discussed in the leading cases may be found in a handful of reported cases that could each support a separate written analysis of at least the length of this brief Article. [19] The manifest

weight of authority, however, strongly favors enforcement of comprehensive and well drafted waivers.

The purpose of this brief article is simply to raise the awareness of lenders and prospective guarantors alike concerning the state of and direction of New York law relating to unconditional guaranties and waivers, and to underscore that guaranties are not more or less all the same. Lenders with updated, comprehensive and well-crafted guaranty documents can achieve very considerable protection in New York against a potential army of defenses and counterclaims and may significantly facilitate, expedite and simplify recovery efforts. Prospective guarantors, conversely, are cautioned to scrupulously review the "fine print" contained in their proposed guaranty documents and carefully review the potential ramifications of any waivers contained in the documents provided by the lender or lender's counsel with their own knowledgeable counsel.

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[1] In the past, lenders also often required the spouse(s) of any principals of the borrower to also execute personal guaranties, however, the insistence by lenders upon spousal guaranties has been greatly curtailed by the provisions of the Equal Credit Opportunity Act (15 U.S.C. §1691 et. seq.) and a variety of specific state statutes proscribing or limiting the situations in which a spousal guaranty may be demanded by a lender.

[2] See, e.g. Compagnie Financiere DeCic ("CFC") v. Merrill Lynch, et al., 188 F.3d 31, 34 (2d Cir. 1999).

[3] Id. at 35; HSH Nordbank AG New York Branch v. Street, 421 Fed. Appx. 70, 73 (2d Cir. 2011).

[4] HSH Nordbank, 421 Fed.Appx. at 73 (citing CFC v. Merrill Lynch, 181 F3d at 36).

[5] Raven Elevator Corp. v. Finklestein, 223 A.D.2d 378 (1st Dept. 1966) lv. den. 88 N.Y.2d 1016 (1966); European Am. Bank. v. Lofrese, et al 182 A.D.2d 67 (2d Dept. 1992).

[6] See, CFC v. Merrill Lynch, 188 F.3d at 35; HSH Nordbank AG New York Branch v. Swerdlow, 672 F.Supp.2d 409, 418 (SDNY 2009).

[7] See, e.g. Hotel 71 Mezz Lender LLC v. Mitchell, 63AD3d 447, 448 (1st Dept. 2009); European Am. Bank. v. Lofrese, et al,182 A.D.2d 67, 73 (2d Dept. 1992).

[8] European AM Bank. v. Lofrese, 182AD2d 67, 71 (2d Dept. 1992).

[9] See, eg. the discussions contained in Phillips Lighting Co. v. Schneider, 2008 WL 4527713 (EDNY 2008), and Design Plumbing & Heating Services, Inc. v. Accurate Blacktop, Inc., 30 Misc.3d1217 (A)(2011).

[10] See, e.g Hotel 71 Mezz Lender, LLC v. Mitchell, 63 A.D. 3d 447, 448 (1st Dept. 2009); Sterling National Bank v. Biaggi, 47 A.D. 3d 436, 437 (2008); Citibank v. Plapinger, 66 N.Y. 2d 90 (1985); Raven Elevator Corp. v. Finkelstein, 223 A.D. 2d 378 (1996), Lv. dismd. 88 N.Y. 2d 1016 (1996).

[11] See, e.g. Red Tulip, LLC v. Neiva, 44 A.D.3d 204, 209 (1st Dept. 2007); JPMCC 2007-CPC 19 Bronx Apt, LLC v. Fordham Fulton, LLC et al, 84AD3d 616 (1st Dept. 2011).

[12] Citibank v. Plapinger, 66 N.Y. 2d 90 (1985).

[13] See e.g. Red Tulip, LLC v. Nevia, et al., 44 A.D. 3d 204, 207-212 (2nd Dept. 2007); Lv.dismd. 10 N.Y. 3d 741 (2008); Fortress Credit Corp. v. Hudson Yards, LLC, 78 A.D. 3d 577 (1st Dept. 2010).

[14] Indianapolis Morris Plan Corp. v. Karlen, 28 N.Y. 2d 30 (1971); Executive Bank of Ft. Lauderdale FLA. v. Tighe, 54 N.Y. 2d 330 (1981).

[15] Quest Commercial, LLC v. Rovner, 35 A.D. 3d 576 (2nd Dept. 2006).
[16] Hotel 71 Mezz Lender LLC v. Mitchell, 63 A.D. 3d 447 (1st Dept. 2009).
[17] See e.g. Sterling National Bank v. Biaggi, 47 A.D. 3d 436 (2008).
[18] Gannett Co., Inc. v. Tessler, 177 A.D. 2d 353 (1st Dept. 1991).
[19] For some case authority distinguishing application of the principles referred to above in fact specific instances; see e.g. Canterbury Realty & Equipment Corp. v. Poughkeepsie Sav. Bank, 135 A.D. 2d 102 (3rd Dept. 1988); Philips Lighting Company v. Schneider, 2008 WL 4527713;MCC Funding, LLC v. Diamond Point Enterprises, 36 Misc. 3d 1206(A), 2012 WL 2537893.