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Guarantor liability: 10 things you should know

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The negotiations and due diligence are over. You are at the closing table, in a hurry, and staring at a stack of form loan documents. When you come to the personal guaranty, you pause and consider whether you fully understand your obligations under the lengthy document in front of you.

Moreover, you ask yourself whether the lender has included the limitation on your liability that you bargained for.

Here are 10 things you ought to know (and remember).

1. Why is the guaranty so long? Under the common law, the rights of guarantors are protected, and guarantors frequently have defenses to liability. Commercial guaranties eliminate many of these rights through specific agreements of the guarantor and specific waivers of rights that the guarantor might otherwise have. The Virginia Supreme Court has held that courts must enforce contracts as written and that courts may not construe contracts to include terms or conditions that both parties did not accept. Consequently, a guarantor cannot know what agreements the guarantor has made in advance with the lender or what rights the guarantor may have waived without carefully reviewing the terms and conditions of the guaranty.

2. Must the lender sue on the note first? No. Most commercial guaranties do not require that the lender sue the borrower first. Most commercial guaranties provide that the guaranty is a guaranty of payment and not a guaranty of collection. As such, the lender has no obligation to attempt to collect from the borrower first.

3. Must the lender foreclose on the collateral first? No. Similarly, most commercial guaranties do not require that the lender foreclose on real property collateral or conduct a UCC sale of personal property collateral before suing on the guaranty.

4. Must the lender sue the other guarantors as well? No. Most commercial guaranties provide the lender with considerable discretion in structuring a collection strategy. The guaranty will typically permit the lender to sue one or more of the guarantors without necessarily being obligated to bring suit against the borrower or any other guarantor.

5. Must the lender possess the original note? No. It is not essential that the lender possess the original promissory note to enforce the obligation of the guarantor under a commercial guaranty. It is usually enough that the lender establish the terms of the primary obligation, the default by the borrower on that obligation, and the non-payment of the amount due. Because the undertaking of the guarantor is a separate, independent obligation, the guarantor remains obligated to the lender until the guaranteed indebtedness has been satisfied.

6. Must the lender sue before the statute of limitations runs on the note? No. The running of the statute of limitations against the borrower on the promissory note does not necessarily extinguish the obligation of the guarantor under the guaranty. Because the guaranty is a separate, independent obligation of the guarantor, the lender does not lose its right to pursue the guarantor until the applicable statute of limitations runs on the obligation of the guarantor under the guaranty.

7. I thought my obligation as guarantor was limited. Commercial guaranties are typically unlimited in amount and of continuing duration until the primary obligation is paid. Commercial guaranties also frequently contain provisions that extend the obligation of the guarantor to future advances made by the lender to the borrower and to extensions, modifications, renewals and refinances of the underlying promissory note. If the guarantor intends that the obligation under the guaranty be limited in some respect, it is imperative that the guaranty set forth the negotiated limitation. In the absence of appropriate limiting language, a Virginia court will be obligated to enforce the guaranty as written and will not resort to evidence external to the guaranty to determine what the lender or the guarantor meant to say.

8. Does my guaranty end on the date of my death? No. The guarantor's obligations under the guaranty are a potential liability for the guarantor's estate after the date of death. Moreover, commercial guaranties frequently provide that the guaranty is applicable to debts created both before and after the death of the guarantor, regardless whether the lender has notice of the death of the guarantor. If the guaranty contains a provision of this type, the executor or administrator of the estate may be able to revoke the guaranty as to future advances and thereby limit potential liability to the amount of the borrower's debt on the date of revocation.

9. Doesn't the lender have to administer the loan in a way that minimizes my potential obligations as guarantor? Guarantors have sometimes asserted as a defense to liability that a lender failed to administer a loan in a manner that could have lessened the potential liability of the guarantor. Notwithstanding these legal theories, the Virginia Supreme Court has made clear that the enforcement by a lender of its rights and remedies under the loan documents (including the commercial guaranty) is permissible, even if the collection strategy selected by the lender has adverse consequences for the guarantor. The court has not imposed on a lender any duty to act in a way that minimizes the potential liability of the guarantor.

10. I thought my obligations were limited because of the non-recourse provisions in the loan documents. Commercial guaranties typically used in non-recourse real estate financing provide that the guarantor may become fully obligated under the guaranty in the event of certain types of defaults by the borrower. A guarantor who thought that his or her liability was limited because of the non-recourse provisions in the loan documents, may be in for a shock if the borrower breaches a specific covenant or promise in the loan documents.

That default may become the basis for the lender to avoid the non-recourse provisions and to pursue collection of the debt in full under the guaranty.

Avoiding unwelcome surprises of this type requires both careful review and negotiation of the non-recourse provisions of the loan documents as well as the events that could trigger full recourse liability on the part of a guarantor.

So read your guaranty carefully. It will be enforceable against you in accordance with its terms. If you have negotiated for limitations on your obligation as guarantor, make sure that your guaranty properly sets forth those limits.

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