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A Guaranty Is Only As Good As The Person Who Signs It:¹ Enforcing Commercial Lending Guaranties In Massachusetts

Financial Institutions and Services Litigation Alert

By Robert W. Sparkes, III and David A. Mawhinney

Guaranties are common practice in the commercial lending industry. Typically, the borrower is a small corporation, limited liability company, or similar entity that is thinly capitalized with few (likely encumbered) assets. Under these circumstances, the borrower's promise to pay a debt is cold comfort to a commercial lender in the event of a default, where its only source of recovery is likely to be the collateral it holds. For this reason, commercial lenders often condition loans not only on a security interest in the borrower's property, but also on a separate, individual guaranty agreement executed by a third party, usually the principals of the corporate borrower. Such guaranties provide another avenue through which commercial lenders may recover loan amounts and damages due to the borrower's default.

As the value of such agreements is dependent on their enforceability, this alert examines the enforceability of guaranty agreements under Massachusetts law. As discussed below, courts applying Massachusetts law regularly enforce guaranties in the commercial context. Accordingly, guaranties are valuable tools for commercial lenders seeking additional security for their loans in Massachusetts, assuming, of course, that the guarantors are "good" for the payment of the debt.

The Basics of a Guaranty

A "guaranty" is defined as "[a] promise to answer for the payment of some debt, or the performance of some duty, in case of the failure of another who is liable in the first instance."² A guaranty depends on the existence of a primary debt obligation.³

Nevertheless, the obligations set forth in a guaranty are collateral to and independent from those in the original loan agreement.⁴

In the commercial lending context, a guaranty is an agreement made by a third party -- often the principal or principals of the commercial borrower -- to satisfy the payment obligations of

¹ See *TOMMY BOY* (Paramount Pictures 1995) ("You know I could guarantee you all day long, but we both know a guarantee is only as good as the man who writes it.")

² BLACK'S LAW DICTIONARY 712 (7th ed. 1999).

³ See *Merchants Nat'l Bank v. Stone*, 296 Mass. 243, 251 (1936) ("the guarantor is bound by the terms of the contract guaranteed [and] . . . [h]is rights rise no higher than those of the principal obligor, and his obligations are coextensive with those of the principal obligor").

⁴ See *Cadle Co. v. Webb*, 66 Mass. App. Ct. 269, 272-73 (Mass. App. Ct. 2006) (explaining that a personal guaranty is "a secondary, collateral promise to pay by the guarantor" that "only activate[s] when and if the note obligor under the instrument of indebtedness fails to meet the obligor's primary and unconditional promise to pay the monies due and owing under the note"); see also *SKW Real Estate Ltd. P'ship v. Gold*, 428 Mass. 520, 521 (1998) ("the defendants' obligation pursuant to the guaranties were separate and distinct from their obligations under the notes"); *Charlestown Five Cents Sav. Bank v. Wolf*, 309 Mass. 547, 549-51 (1941).

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the borrower upon an event of default (i.e., payment delinquency by the primary obligor/borrower).⁵ The guaranty is ordinarily executed at the same time as the underlying loan documents (which would include a promissory note, security agreement, and any other assignment documents)⁶ and serves as a form of collateral to support the underlying loan made to the borrower.⁷

A common form of guaranty in the commercial loan context is an absolute or unconditional guaranty.⁸ Under an unconditional guaranty, a guarantor is personally liable for the underlying borrower's obligations upon the borrower's default; no other conditions or events are necessary to impose liability.⁹ As such, a lender need not first attempt to recover the debt from the borrower or exhaust rights under the loan agreement.¹⁰ No magic words are required to create an absolute or unconditional guarantee, so long as the agreement does not contain express limitations or conditions upon the lender's exercise of its rights thereunder.¹¹

Strict Enforcement Under Massachusetts Law

Under Massachusetts law, a lender or assignee seeking to enforce a guaranty must establish the following elements: (1) a primary obligation (i.e., the loan evidenced by a promissory note or other loan agreement);¹² (2) a writing signed by the guarantor and evidencing the guarantor's promise to satisfy the obligations of the primary obligor;¹³ (3) consideration, which, in most cases, may be the provision of the loan funds under the contemporaneously executed loan agreement;¹⁴ (4) default of the primary obligation;¹⁵ (5)

⁵ See, e.g., *Charlestown Five Cents Sav. Bank*, 309 Mass. at 549-50 (“[t]he ordinary meaning of the word [guarantee] is that some one else is primarily liable for a debt and that the guarantor will pay it if the primary debtor does not”); see also *Federal Fin. Co. v. Savage*, 431 Mass. 814, 815 (2000) (guarantors were president and other officer of corporate borrower and agreed to become personally liable for all present and future indebtedness of the corporate borrower).

⁶ See 17 MASSACHUSETTS PRACTICE: PRIMA FACIE CASE PROOF AND DEFENSE § 11.7 (5th ed. 1995) (identifying presumption that a guaranty is executed at the same time as the primary obligation). One benefit of the contemporaneous execution of a guaranty is that, under Massachusetts law, the extension of credit to the borrower serves as the consideration to support the guaranty. See Note 14, *infra*.

⁷ See *Cadle Co.*, 66 Mass. App. Ct. at 272.

⁸ See, e.g., *Lexington Sav. Bank v. Plante*, No. 922871, 1993 WL 818885, at *2 (Mass. Super. Ct. Dec. 23, 1993); *Merillat Indus., Inc. v. Johnston*, 865 F. Supp. 60, 63 (D. Mass. 1994); *In re BB Island Capital, LLC*, 540 B.R. 16, 18 (Bankr. D. Mass. 2015).

⁹ *First Colonial Bank for Savings v. Webster*, No. 926679B, 1993 WL 818626, at *2 (Mass. Super. Ct. Oct. 12, 1993) (citing *Shawmut Bank, N.A. v. Wayman*, 34 Mass. App. Ct. 20, 23-24 (Mass. App. Ct. 1993)).

¹⁰ See, e.g., *In re BB Island Capital, LLC*, 540 B.R. at 18 (quoting guaranty provision that the guaranty was “in no way conditioned upon any requirement that the Bank first attempt to collect any of the Obligation from the Borrower”); *Banknorth, N.A. v. Alticom, Inc.*, No. 041931E, 21 Mass. L. Rptr. 682, at *1 (Mass. Super. Ct. Oct. 23, 2006) (guaranty “allowed [lender] to pursue claims for overdue debt against the guarantors regardless of whether it had first attempted to collect the debt from [the borrower]”).

¹¹ See *Lexington Sav. Bank*, 1993 WL 818885, at *2 (“A guaranty that is absolute and unconditional is one that requires no condition precedent to its enforcement against the guarantor other than the mere default by the principal obligor.”); *Merillat Indus.*, 865 F. Supp. at 63 (“[t]he Guarantee at issue specifically and clearly states that it is unconditional”).

¹² See *Charlestown Five Cents Sav. Bank*, 309 Mass. at 549-50.

¹³ See Mass. Gen. Laws ch. 259, § 1 (requiring that any contract to “charge a person upon a special promise to answer for the debt, default or misdoings of another” be “in writing and signed by the party to be charged therewith”); *Colpitts v. L.C. Fisher Co.*, 289 Mass. 232, 234 (1935).

¹⁴ See *Tenney v. Prince*, 21 Mass. 385, 402 (1826); see also *Davis-Hill Co. v. Wells*, 254 Mass. 118, 123 (1925) (holding that a guaranty that is executed contemporaneously with the primary obligation may rest upon the same consideration); *Rome v. Gaunt*, 246 Mass. 82, 94 (1923) (“the furnishing of credit to the company by the plaintiff on the strength of the defendant's promise is a sufficient consideration to support the guaranty.”).

¹⁵ See *Cadle Co.*, 66 Mass. App. Ct. at 272.

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compliance by the lender with the terms of the original contract and guaranty;¹⁶ and (6) the primary obligation remains unpaid.¹⁷

In assessing these elements, Massachusetts courts construe and enforce a guaranty strictly according to its plain language.¹⁸ Thus, “[w]hen the words of the guaranty are clear they alone determine the meaning.”¹⁹ Courts in Massachusetts have faithfully applied this maxim, such that a guarantor’s liability is simple -- “[i]f the principal defaults on its obligations, the guarantor must pay in accordance with the guaranty’s terms.”²⁰ Indeed, as the Massachusetts Supreme Judicial Court (“SJC”) succinctly explained in a case involving “an arm’s-length transaction between sophisticated individuals culminating in the defendant’s company receiving the benefit of two bank loans,” “the company defaulted and the defendant is now obligated to repay.”²¹ Simply put, where the evidence demonstrates that the guarantor executed an unconditional guaranty, an event of default occurred, and the amounts due under the loan documents remain outstanding, a lender plaintiff has set forth a *prima facie* entitlement to relief.²²

It is well established in Massachusetts that public policy strongly favors strict enforcement of commercial loan guaranties. That is because courts seek to enforce the expectations of sophisticated business entities and individuals, provide certainty in business transactions, and ensure the free flow of credit.²³ Indeed, the SJC has explained that, in commercial transactions between sophisticated persons, “[i]t would be unfair to the [lender] and upset certainty in loan transactions” to permit a guarantor to avoid his or her contractual obligations.²⁴

Waiver of Defenses to Enforcement

Against this legal backdrop, lenders seeking to enforce personal guaranties have a favorable audience in Massachusetts courts. However, after a lender establishes a *prima facie* case, what defenses or counterclaims may a guarantor assert and how may those impact the

¹⁶ See *Davis-Hill Co.*, 254 Mass. at 125.

¹⁷ See *Charlestown Five Cents Sav. Bank v. Zeff*, 275 Mass. 408, 410 (1931) (enforcing guaranty where lender sought to recover unpaid portion of note from guarantors after foreclosure on property failed to satisfy the total amount of the outstanding debt).

¹⁸ *Federal Fin.*, 431 Mass. at 817; see also *Zeff*, 275 Mass. at 411 (“[t]he liability of the guarantors is to be ascertained from the terms of the written instrument by which their obligation is expressed”); *Citizens Bank of Mass. v. Milligan*, No. 050104, 2006 WL 416963, at *3 (Mass. Super. Ct. Feb. 1, 2006).

¹⁹ *Federal Fin.*, 431 Mass. at 817 (internal quotation marks omitted).

²⁰ *First Colonial Bank for Savings*, 1993 WL 818626, at *2 (citing *Shawmut Bank*, 34 Mass. App. Ct. at 23-24).

²¹ *Federal Fin.*, 431 Mass. at 820-21.

²² See *SKW Real Estate Ltd. P’ship*, 428 Mass. at 523-25 (1998) (“defendants’ guaranties were absolute and unconditional, entitling the plaintiff to require the defendants to fulfil the obligations they undertook thereunder”); *Shawmut Bank*, 34 Mass. App. Ct. at 23-24 (“If the principal defaults on its obligations, the guarantor must pay in accordance with the guaranty’s terms.”); *Baynorth Realty Fund VI, L.P. v. Shoaf*, No. 09-4303-BLS2, 2010 WL 5071831, at *3 (Mass. Super. Ct. Oct. 19, 2010) (finding that lender satisfied its summary judgment burden because “the record establishes as undisputed that the defendants executed the guaranty; that [borrower] filed for bankruptcy protection with the loan outstanding, and the defendants have not paid the amounts demanded”).

²³ See *Federal Fin.*, 431 Mass. at 820-21; *Baynorth Realty Fund VI, L.P.*, at 2010 WL 5071831, at *5 (Massachusetts courts favor enforcement of guaranties “since a contrary result would undermine the commercial value of loan guaranties in general, with a resulting negative effect on availability of credit”).

²⁴ *Federal Fin.*, 431 Mass. at 820-21; *SKW Real Estate Ltd. P’ship*, 428 Mass. at 525 (enforcing guaranty where guarantors were “seemingly experienced business persons . . . engaging in a sophisticated commercial transaction involving large sums of money”).

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lender's ability to recover all or part of the defaulted debt from the guarantor? Predictably, the answer depends on the terms of the guaranty at issue.

Commercial lenders may limit the potential defenses available to a guarantor through express contractual waivers. Commercial loan guaranties in Massachusetts, and elsewhere, often contain provisions whereby the guarantor expressly waives the ability to assert certain rights and defenses to a lender's enforcement efforts.²⁵ These may constitute waivers of certain notice requirements or waivers of specific claims, counterclaims, or defenses to enforcement.²⁶ These types of waivers serve to streamline the enforcement of a guaranty, in part, by removing fact-based defenses and permitting a straightforward presentation and application of the guaranty's contractual terms.

Consistent with the principles discussed above, courts applying Massachusetts law routinely enforce defense-waiver provisions in commercial loan guaranties.²⁷ That is because, as with guaranties generally, courts view such waivers as bargained-for concessions between sophisticated parties that should be enforced by their plain terms.²⁸ While a lender may not be able to immunize itself from all potential defenses (and such waivers are only as broad as drafted and agreed-to among the parties), express contractual waivers are useful tools in maximizing the enforceability of personal guaranties under Massachusetts law.

Putting aside the issue of waiver, guarantors may also attempt to assert defenses or counterclaims belonging to the borrower. Such defenses or counterclaims may arise from the underlying loan agreement or from the relationship and course of dealing between the lender and the borrower. These challenges are likely to have little traction with courts in Massachusetts. That is because, in general, a guarantor is not a party to the underlying loan agreement and cannot advance the claims that belong to the principal borrower.²⁹ A guaranty provides the lender with a wholly independent avenue of recourse against the guarantor that arises from the guarantor's separate contractual obligations in the guaranty.³⁰ As the Massachusetts Superior Court has explained,

“Guarantors are in effect debt investors whose fortunes rise and fall with the company's successes and failures. . . . [T]hey are “contingent creditors” who, like original creditors, cannot recover directly for injury inflicted on a business.

²⁵ See Notes 26, 27, & 28, *infra*.

²⁶ See, e.g., *Baynorth Realty Fund VI, L.P.*, 2010 WL 5071831, at *1 (“each Guarantor hereby waives any claim, counterclaim or defense based on or otherwise involving, any act or thing that would constitute a legal or equitable discharge, including . . . any other matter that would constitute a defense available to [the borrower]”); *Shawmut Bank*, 34 Mass. App. Ct. at 23-24 (guaranty included waiver of “notice” provisions of loan agreement and of certain “defenses”); *First Colonial Bank for Savings*, 1993 WL 818626, at *4 (enforcing waiver of “any and all defenses to any action . . . brought to enforce [the] guaranty . . . either at law or in equity”).

²⁷ See *Cambridgeport Sav. Bank v. Boersner*, 413 Mass. 432, 443 (1992) (affirming denial of guarantors' motion to add themselves as plaintiffs-in-counterclaim alleging breach of implied covenant of good faith and fair dealing and violation of Chapter 93A because guarantors had waived these claims under the terms of their guaranties); *Baynorth Realty Fund VI, L.P.*, 2010 WL 5071831, at *3-4 (rejecting guarantor's bad faith theory as waived); *Merillat Indus.*, 865 F. Supp. at 63.

²⁸ See *Shawmut Bank*, 34 Mass. App. Ct. at 23-24 (finding guarantor “bound by the express terms of the guaranty waiving her right to . . . notice and assent”); *First Colonial Bank for Savings*, 1993 WL 818626, at *4; *Baynorth Realty Fund VI, L.P.*, 2010 WL 5071831, at *4-5.

²⁹ See *Siderius, Inc. v. Striberg*, 16 Mass. App. Ct. 962, 962 (Mass. App. Ct. 1983); *Array Fin. Servs. Inc. v. Gennari*, No. SUCV201104219BLS2, 2012 WL 6016885, at *2 (Mass. Super. Ct. Sept. 21, 2012); see also *Merillat Indus.*, 865 F. Supp. at 65 (“a lender . . . is under no duty to a guarantor of a loan . . . to exercise due care in dealing with the borrowers”).

³⁰ See, e.g., *Siderius, Inc.*, 16 Mass. App. Ct. at 962; *Array Fin. Servs., Inc.*, 2012 WL 6016885, at *2; *Merillat Indus.*, 865 F. Supp. at 65 (rejecting defense based upon lender's alleged misconduct with respect to the borrower, not alleged misconduct allegedly directed to guarantor).

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. . . They cannot directly sue those they believe responsible for the corporation's failure, since that is a cause of action belonging only to the company.³¹

Accordingly, absent unique circumstances, a guarantor ordinarily lacks standing to assert and cannot avail itself of any defenses or counterclaims inuring to the borrower.

Conclusion

Under Massachusetts law, commercial guaranties are strictly enforced according to their contractual provisions and their enforcement is favored as a matter of public policy. That policy suggests that lenders should take great care to draft clear, direct, and unconditional guaranties and waiver provisions therein. While lenders cannot directly control the ability of a commercial borrower to pay its loan debt or the ability of a guarantor to satisfy the debt upon default, they can maximize their ability to recover all or some portion of defaulted debts in Massachusetts through the vehicle of a well-drafted guaranty.

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³¹ See *Array Fin. Servs., Inc.*, 2012 WL 6016885, at *2.