TEXAS ANNOTATED GUARANTY

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CHAPTER 1.17

INTRODUCTION

This Annotated Guaranty, while primarily the effort of Edward A. Peterson, John M. Nolan and others in 2001, has now become a firm-wide effort. The materials have been updated several times, most recently by the authors. The Annotated Guaranty is intended to provide the reader with a comprehensive form of Guaranty for use in a permanent commercial loan secured by a first lien on improved real property located in Texas. This form includes optional provisions for situations in which a loan agreement is being executed in connection with the transaction (such as in a construction loan context). This Guaranty also addresses several issues and concepts common in loans securitized in the capital markets, but would need further modification to be utilized as a CMBS loan instrument. As with any generic form, the practitioner must tailor the instrument to the specific needs of the client and the factual context of the given loan transaction.

This Guaranty can be used for the purposes described below in connection with the Annotated Promissory Note (cited in the annotations to this Guaranty as the "Annotated Promissory Note") and the Annotated Deed of Trust (cited in the annotations to this Guaranty as the "Annotated Deed of Trust"). On June 17, 2011, Senate Bill 889 was signed into law, creating a statutory process for creditors to take a security interest in rents as security for a real estate loan. In light of this new legislation governing assignments of rent, we have removed all references in this Guaranty to the "Annotated Assignment of Rents," also authored by this firm.

The broad purposes of this presentation are to provide a comprehensive form of guaranty with detailed annotations drawing upon statutory law, case law, practical observations and drafting concepts for use by practitioners and their clients in a commercial real estate practice. This presentation contains significant commentary from a number of lawyers in the firm's Construction and Surety, Litigation, Financial Institutions, Bankruptcy, Estate Planning and Taxation Practice Groups, contributing insights often unavailable to real estate practitioners. These annotations are not intended to constitute a legal opinion and, while comprehensive (even citing to legislation just recently or yet to be enacted or effective), are not and cannot be dispositive of every issue or factual circumstance that a practitioner or party will encounter in the negotiation and preparation of a Guaranty. It is our belief that this presentation can, at a minimum, provide the following:

- assistance in the preparation of guaranties and other loan documents
- a valuable tool for counsel, whether representing the guarantor or the lender, in negotiating a guaranty, and as an ancillary benefit to those negotiations, "educating" their respective clients as to the reasons for the inclusion or, where applicable, modification or exclusion, of the provisions contained in this Guaranty
- a resource for the preparation and negotiation of legal opinions in commercial lending transactions
- a valuable tool for the training of lawyers

As noted above, many attorneys, both within and outside the Real Estate Practice Groups at Winstead, provided valuable insight and research assistance to the authors in producing this presentation. Our acknowledgment is inadequate recognition of their efforts, but we would like to acknowledge with gratitude the assistance of Michelle Rieger (Construction and Surety), Eli Columbus and Phil Lamberson (Bankruptcy), Brian Morris (Litigation), Nancy Furney (ERISA and related laws), Mike Hilliard, Richard Leucht and Mike O'Neal (Financial Institutions), John Bergner and Tricia English (Wealth Preservation) and Keith Mullen and Brian Short (Real Estate Finance). Without this "team" effort, the quality of the end product would not have been possible.

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GUARANTY

THIS GUARANTY[1] (this "Guaranty") is executed and entered into as of _______________, 20___, by ____, a ____________________

[1] A guaranty is a promise of one party to answer for the debts or obligations of another. *See* Texas Tractor Co. v. Tex. Power & Light Co., 412 S.W.2d 935, 937 (Tex. Civ. App.–Waco 1967, no writ). It is vital that a guaranty be unambiguous and completely set forth the agreement between the lender and the guarantor. A guaranty will be interpreted under the rule of *strictissimi juris*, which prohibits the extension of the guarantor's obligations beyond the written terms of the guaranty. *See* Vastine v. Bank of Dallas, 808 S.W.2d 463, 464 (Tex. 1991). Any ambiguity is resolved in favor of the guarantor. *See* Clark v. Walker-Kurth Lumber Co., 689 S.W.2d 275, 278 (Tex. App.–Houston [1st Dist.] 1985, writ ref'd n.r.e.). *See also* first annotation to Rider 1 (Limitations of Guaranteed Indebtedness), *infra*, discussing the importance of clarity.

Suretyship and guaranty relationships are most often created by contract. A surety, by contract, agrees to be responsible for the debt of the principal. A surety who sustains a loss has an equitable right, and often a contractual right, to pursue the principal for repayment of the loss sustained. Another basic form of such a contractual relationship is a guaranty. Similar to a surety, "a guarantor typically contracts to fulfill an obligation upon default of the principal obligor (maker)." *See* RESTATEMENT (THIRD) OF SURETYSHIP AND GUARANTY § 1 (1996), comments (b) and (c). Although there are important distinctions between these two types of legal relationships, the distinctions relate mostly to the duties *contractually* imposed upon a guarantor or surety. For example, there are numerous provisions in this Guaranty that cause Guarantor to waive defenses it would normally have. These defenses exist statutorily, constitutionally, and at common law and are equally applicable in the typical surety context. When a guarantor waives defenses contractually, this waiver creates a distinction between a guarantor and a surety. There are other practical distinctions as well. A guarantor may not have the same leverage in the negotiation of its rights and remedies as would a surety, primarily because the lender controls whether the underlying loan will be made to the borrower. Because the typical rights and remedies of a guarantor are derived from the same underlying legal principles as those of a surety, an effort has been made in this Guaranty to explain (i) the particular underlying right, (ii) the effect of a guarantor's waiver of that right, and (iii) the application of the distinctive legal theories between a true surety context and a guaranty relationship.

This Guaranty is prepared for use in a real estate secured loan transaction, pursuant to which Guarantor guarantees *payment* of all indebtedness of Borrower to Lender, and *performance* of all covenants and agreements made by Borrower to Lender under the Loan Documents. This guaranty of payment of the Guaranteed Indebtedness and performance of the other Guaranteed Obligations, however, may be limited if agreed to by Lender. For example, Rider 1 (Limitations of Guaranteed Indebtedness), *infra*, includes suggested language for those situations in which Lender agrees to limit Guarantor's liability for payment of the Guaranteed Indebtedness, either to a certain amount or percentage of the Loan, or, in the case of a non-recourse loan, to certain costs, damages or expenses incurred by Lender if a specified "bad boy act" occurs. *See* annotations to Rider 1 (Limitations of Guaranteed Indebtedness), *infra*, for a more in-depth discussion of these issues. Furthermore, while this Guaranty is primarily intended for use with a permanent or mini-perm real estate loan, Rider 2 (Additional Construction Loan Performance Obligations), *infra*, provides suggested, alternative language for use with a construction loan.

Although for many real estate practitioners a guaranty is primarily encountered in a lending context, a guaranty is also very common in other types of real estate transactions. Common uses for a guaranty include lease guaranties (typically as a credit enhancement mechanism), guaranties of various types of contractual obligations (such as the buyer's closing obligations under a build-to-suit contract of sale), and guaranties of the performance of certain key provisions under an entity's organizational documents. For example, an investor may require, in certain circumstances, as a condition precedent to investing in a new venture, that an individual or entity having sufficient financial strength and affiliated with another investor in the venture, guarantee the obligation of such other investor to make required capital contributions as provided in the operative organizational documents of the venture. Although this Guaranty is intended for use in connection with a real estate secured loan, practitioners should be (whether one or more, and together with each such Person's respective **[executors, personal representatives,]** permitted successors and permitted assigns, being hereinafter referred to as "Guarantor")[2], in favor of ______________________________, a ______________________________

aware of these other types of guaranties and the corresponding potential applicability of the provisions and annotations of this Guaranty to those transactions.

[2] A guarantor promises to perform an act of the same kind and content as another is contractually bound to perform. *See* Simmons v. Compania Financiera Libano, S.A., 830 S.W.2d 789, 792 (Tex. App.–Houston [1st Dist.] 1992, writ denied). "For there to be a guarantor there must be a primary obligation on the part of another the performance of which is guaranteed." Moore v. Grain Dealers Mut. Ins. Co., 450 S.W.2d 954, 957 (Tex. Civ. App.–Houston [1st Dist.] 1970, no writ).

A lender typically will select as guarantors those principals (shareholder, partner, member or other owner) of the borrower who have a large investment or interest in the borrower and a strong balance sheet. The reasons for this selection are that these persons have: (i) a significant stake in the borrower and, consequently, have a pronounced interest in the profitable operation of the borrower and the mortgaged property and in repayment of the loan, and (ii) depending on such person's true net worth, the financial ability to repay the loan, if necessary.

Although this Guaranty primarily addresses transactions where a guarantor is either a principal or affiliate of the borrower, lenders are regularly requiring guaranties in commercial real estate transactions that are more of a true credit enhancement from unrelated, third parties. In such instances, the nature and scope of the negotiation of many of the provisions contained in this Guaranty can take on a significantly different approach. Often a guarantor who is also a principal of the borrower is executing a guaranty for the combined reasons of (i) providing some level of financial backing for the payment by, and performance of, the borrower under the loan, which varies from transaction to transaction, and (ii) equally as important, providing an appropriate level of "focus" by the principals of either the borrower or its general partner or managing member to the performance obligations of the borrower in a given transaction, especially in a construction loan. In the third party credit-enhancement context, however, the primary focus of the lender is on the actual credit being provided by that third party guarantor, which has the corresponding effect of forcing the lender to negotiate a guaranty with a third party that has substantial assets. For this reason, a guarantor that credit enhances debt will often have a different set of concerns and needs than an "insider" guarantor, such as separate, concurrent notices, and notice and cure periods that extend beyond the notice and cure periods (if any) provided to the borrower, as may be necessary for (i) giving the guarantor sufficient time to cure borrower's default under the loan documents, (ii) replacing the loan or (iii) negotiating the extent to which the guarantor will be entitled to use loan proceeds to satisfy, in whole or in part, the performance obligations contained within the guaranty. In connection with a third party credit-enhancement guaranty, the guarantor will likely will have separately negotiated with the borrower the ability of the guarantor to pursue or seek reimbursement from the borrower if such guarantor has to perform any obligations under the loan documents on the borrower's behalf. In such situations, the guarantor will usually attempt to preclude the inclusion of a waiver of subrogation clause in this Guaranty [*see* Section 4.4 (Waiver of Subrogation Rights), *infra*, for a proposed waiver of subrogation clause]).

The definition of "Guarantor" should include any "permitted" successors and "permitted" assigns of Guarantor together with the executor and personal representatives of the Guarantor. *See* third annotation to the definition of "Default", *infra*. Contracts are assignable as a general rule. *See* Cloughly v. NBC-Bank-Sequin, N.A., 773 S.W.2d 652, 655 (Tex. App.–San Antonio 1989, writ denied). However, an exception to this general rule of contract assignability is that a contract that relies on the personal trust, confidence, skill, character or *credit of the parties* may not be assigned without the consent of the other parties to the contract. *See* Moore v. Mohon, 514 S.W.2d 508, 513 (Tex. Civ. App.–Waco 1974, no writ). A guaranty is a contract that relies upon the credit of the guarantor and, as such, may not be assigned by the guarantor without the lender's consent. *See* Amsco Pipe Line Co. v. Donico Prod. Co., 112 S.W.2d 483, 485 (Tex. Civ. App.–San Antonio 1938, writ dism'd); Central Power & Light Co. v. Purvis, 67 S.W.2d 1086 (Tex. Civ. App.–San Antonio 1934, writ ref'd). This definition of "Guarantor" is intended to include successors and assigns of Guarantor as may be consented to or permitted by Lender, without implying Lender's consent to any such assignment in the Guaranty itself. *See also* annotations to Section 6.3 (Binding Effect), *infra*.

_______________ (together with its successors and assigns, any subsequent holder(s) of the Note **[, and any of its Affiliates providing an Interest Rate Protection Agreement]**, being hereinafter referred to as "Lender").[3] All terms in this Guaranty with initial capitalized letters are defined Section 1.1 below.

Also note that the parties to the guaranty should be expressly and accurately identified on the face of the guaranty in such a manner as to remove any doubt as to their identity. However, absolute accuracy in the spelling of a party's name in a legal document is not always required for the document to be legally enforceable under the rule of *idem sonans*. As long as an incorrect spelling sounds practically identical to the correct name when commonly pronounced, the incorrect spelling may nevertheless constitute sufficient identification of the party. *See* Chumney v. Craig, 805 S.W.2d 864, 866 (Tex. App.–Waco 1991, writ denied); Cockrell v. Estevez, 737 S.W.2d 138, 139 (Tex. App.–San Antonio 1987, no writ); Means v. Protestant Episcopal Church Council of the Diocese of Texas, 503 S.W.2d 591, 592 (Tex. Civ. App.–Houston [1st Dist.] 1973, writ ref'd n.r.e.).

[3] Most guaranties and loan documents include language similar to "successors, assigns and subsequent holders of the promissory note" within the definition of "lender." The addition of this language, while apparently not required under Texas law, reflects that the loan and the loan documents may be transferred or assigned by lender. For example, a promissory note, even if the note is nonnegotiable, may nevertheless be assigned if it does not contain language limiting its assignability. *See* Lexington Ins. Co. v. Gray, 775 S.W.2d 679, 682 (Tex. App.–Austin 1989, writ denied). A lender may also assign a guaranty along with the underlying note when there is no wording in the guaranty prohibiting its assignment. *See* Boyd v. Diversified Fin. Sys., 1 S.W.3d 888 (Tex. App.–Dallas 1999, no pet.); Thompson v. N. Tex. Nat'l Bank, 37 S.W.2d 735 (Tex. 1931). However, it is prudent practice to include language in the note, the guaranty and the other loan documents expressly permitting an assignment by the lender, especially when lender anticipates that it will assign the entirety of the loan, or participate or syndicate out portions of the loan, to other lenders. CMBS lenders and other lenders that securitize their loans and therefor intend to eventually assign every loan they make will routinely include a provision stating that the note and the other loan documents, and lender's rights thereunder, may be assigned in whole or in part. *See also* annotation to Section 6.7 (Participation; Disclosure of Information), *infra*.

The definition of "Lender" in this Guaranty also includes optional language for "Affiliates" of Lender providing an Interest Rate Protection Agreement because the Guaranteed Obligations include liabilities related to any Interest Rate Protection Agreement. *See* definition of "Interest Rate Protection Agreement" and the annotation thereto in Section 1.1 (Definitions), *infra*, for an explanation of this term and the situations in which an Interest Rate Protection Agreement may be beneficial. This expanded definition is necessary because a number of financial institutions use a separate affiliate as the counterparty in Interest Rate Protection Agreements.

Also note that if the lender is not organized under Texas law, a determination should be made as to whether the lender is required to qualify to do business in Texas by virtue of making and servicing the loan and the lender's other activities in Texas. The mere origination, funding and servicing of a loan (so long as those activities are conducted outside of Texas) will not by itself (i) constitute doing business in Texas or (ii) require registration by or licensing of the lender as a foreign corporation in Texas. *See* TEX. BUS. ORGS. CODE ANN. §9.251, 9.252 (West 2010). The Texas Business Organizations Code addresses the admission of foreign limited liability companies and business corporations, respectively, and the requirements to obtain a certificate of authority (evidence of qualification to do business) from the Secretary of State of the State of Texas. Under the foregoing statutes, there are certain activities by which a foreign company or corporation "shall not be considered to be transacting business in this State, for purposes of this Act, by reason of carrying on in this State any one or more of the following activities: . . . (7) Creating as borrower or lender, or acquiring, indebtedness or mortgages or other security interests in real or personal property; (8) Securing or collecting debts due to it or enforcing any rights in property securing the same." *Id.*

RECITALS

A. **[*No Loan Agreement*: Borrower has become indebted, and may from time to time be further indebted, to Lender with respect to the Loan.] [*With a Loan Agreement*: Lender and Borrower have entered into, or are entering into concurrently herewith, the Loan Agreement which sets forth the terms and conditions of the Loan.]**[4]

B. It is expressly agreed and understood by and among Borrower, Lender and Guarantor that the execution and delivery to Lender of this Guaranty is a condition precedent to Lender entering into the Loan Documents and making the Loan, or otherwise extending credit, to Borrower, that Lender is relying on this Guaranty in making the Loan to Borrower, and that Lender would not make the Loan to Borrower without this Guaranty.[5]

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[4] This Guaranty is primarily intended for use in connection with a permanent real estate loan without use of a loan agreement. This form, however, incorporates optional, bold language when borrower and lender have entered into a loan agreement governing the use of loan proceeds. Accordingly, this form has been prepared to be adaptable for use with a loan agreement. For example, Rider 2 (Additional Construction Loan Performance Obligations), *infra*, incorporates several provisions typically found in a guaranty in a construction loan context, whereby a construction loan agreement has been entered into between borrower and lender setting forth certain conditions to construction advances and other standards, requirements and criteria to be complied with by the borrower with respect to completion of improvements. Accordingly, Rider 2 adds specific Guaranteed Obligations with respect to construction.

[5] It is a basic tenet of common law that a contract must be supported by consideration to be enforceable. *See* 1A Corbin, Contracts § 210 (1963 & Supp. 1980); Moore & Moore Drilling Co. v. White, 345 S.W.2d 550 (Tex. Civ. App.–Dallas 1961, writ ref'd n.r.e.). A guaranty, like any contract, requires legal consideration to be enforceable. However, to support a guaranty, it is not necessary that the consideration pass directly to the guarantor. Generally, sufficient consideration exists if the borrower receives a benefit from, or the lender suffers detriment from, the transaction as a whole. *See* Hargis v. Radio Corp. of Am. Elec. Co., 539 S.W.2d 230 (Tex. Civ. App.–Austin 1976, no writ). More specifically, a guaranty given to induce a lender to loan funds is sufficient consideration. *See* Simpson v. MBank Dallas, N.A., 724 S.W.2d 102 (Tex. App.–Dallas 1987, writ ref'd n.r.e.). Consideration that flows to the borrower alone will suffice to bind the guarantor. *See* Bonner Oil Co. v. Gaines, 191 S.W. 552 (Tex. 1917). *See also* Whitten v. Alling & Cary Co., 526 S.W.2d 245, 248 (Tex. Civ. App.–Tyler 1975, writ ref'd); Dean v. Allied Oil Co., 261 S.W.2d 900, 902 (Tex. Civ. App.–Waco 1953, writ dism'd). Accordingly, Texas courts have specifically held that a loan given partially or completely on the "faith" (*i.e., reliance*) of the guaranty is sufficient consideration to support the guaranty. *See* Diamond Paint Co. of Houston v. Embry, 525 S.W.2d 529, 533 (Tex. Civ. App.–Houston [14th Dist.] 1975, writ ref'd n.r.e.); Union Cent. Life Ins. Co. v. Roach, 106 S.W.2d 374, 377 (Tex. Civ. App.–Waco 1937, writ dism'd). *See also* Timothy R. Zinnecker, Lawyers Who Draft and Negotiate Guaranties (and the Clients Who Love Them), 35 S. TEXAS L. REV 387, 391 (1994) (pointing out that, technically, a borrower-related guarantor receives de facto consideration because the capital stock of the borrower is also an asset of the guarantor. As such, the extension of credit to the borrower directly benefits the related party guarantor). Furthermore, in Texas, the burden of proof is on the guarantor to show that there is a failure of consideration. *See* Holland v. First Nat'l. Bank in Dallas, 597 S.W.2d 406, 408 (Tex. Civ. App.–Dallas, 1980, writ dism'd); Maykus v. Texas Bank & Trust Co. of Dallas, 550 S.W.2d 396, 398 (Tex. Civ. App.–Dallas, 1977, no writ).

Lack of consideration, therefore, is generally not an issue when the guaranty is entered into simultaneously with the underlying obligation. However, it is not the loan to the borrower that is the consideration for the guarantor's promise, but rather the fact that the loan was extended in return for (*i.e.*, in reliance upon) the guarantor's promise. *See* Ivan C. Harrell & Jesse J. Norton, Fundamental Legal Considerations Respecting Accommodation Parties, Guarantors, and Sureties, at 11 (St. B. Tex. Bull. Banking Bus. L. 1988).

C. Guarantor is the beneficial owner of a direct or indirect interest in Borrower **[and is an Affiliate/officer/partner/member/shareholder of Borrower]**, the value of the consideration and benefit received and to be received by Guarantor, directly or indirectly, as a result of Lender making the Loan to Borrower and Guarantor executing and delivering this Guaranty, is reasonably worth at least as much as the liability and obligation of Guarantor hereunder, and the Loan has benefited and may reasonably be expected to benefit Guarantor, directly or indirectly.[6]

The foregoing illustrates a possible problem if a guaranty is entered into independently of the underlying loan transaction. In these circumstances, a guaranty must be supported by consideration independent of the underlying obligation. *See* Gooch v. Am. Sling Co., Inc., 902 S.W.2d 181, 185 (Tex. App.–Fort Worth, 1995, no writ); Universal Metals & Mach., Inc. v. Bohart, 539 S.W.2d 874 (Tex. 1976). Consideration usually consists either of the suffering of a detriment by the lender or a benefit conferred upon the borrower. *See* Fourticq v. Fireman's Fund Ins. Co., 679 S.W.2d 562, 564 (Tex. App.–Dallas, 1984, no writ). For example, postponing the enforcement of a debt has been held to be sufficient consideration. *See* Swofford v. Tri-State Chems., Inc., 764 S.W.2d 24, 26 (Tex. App.–El Paso, 1989, writ denied); McWhorter v. First State Bank of Wylie, 11 S.W.2d 808 (Tex. Civ. App.–Dallas 1928, writ ref'd). 226 S.W.3d 396 (Tex. 2007), where the Court determined that a guaranty that was executed in connection with the renewal of a promissory note was supported by sufficient consideration when the lender agreed to forgo acceleration of the debt and extend the original debt instead. However, even if a guaranty is executed after the creation or making of the underlying loan, the guaranty may still be supported by consideration if there was an understanding that the guarantor would execute the guaranty a short time later. *See, e.g.,* First Commerce Bank v. Palmer, 226 S.W.3d 396 (Tex. 2007) (holding that bank's forbearance of prior guaranties and agreement to renew and extend debt was sufficient consideration for subsequent guaranties); Commercial State Bank of Forreston v. Folkerts, 200 Ill. App. 385 (1916). The problem with this approach though is that the burden of proving that the subsequent guaranty was a condition of the prior extension of the loan is often difficult. This burden grows as the gap of time between the original loan transaction and the execution of the guaranty widens. Although it is true that a written instrument reciting consideration imparts consideration, this presumption can be successfully rebutted with competent evidence. *See* Williams v. Hill, 396 S.W.2d 911 (Tex. Civ. App.–Dallas 1965, no writ). At least one commentator suggests that a possible solution to this problem would be to shorten the maturity of the underlying promissory note or to initially place the note on a demand basis until the guaranty is delivered, at which time the note would be extended or amended accordingly. *See generally*, Robert M. Lloyd, Loan Guaranty Contracts: How to Make Them Enforceable, 107 BANKING L.J. 292, 295 (July-August 1990).

[6] Any corporation has the power and authority to make a guaranty if the guaranty may be reasonably expected to benefit the guarantor corporation either directly or indirectly. *See* TEX. BUS. ORGS CODE ANN. § 2.104 (West 2010). The acts of a corporation's officers or agents can create a valid guaranty binding on the corporation through the exercise of their apparent authority. *See* Ginsberg 1985 Real Estate P'ship v. Cadle Co., 39 F.3d 528 (5th Cir. 1994); Paramount Nat'l Life Ins. Co. v. Williams, 772 S.W.2d 255, 262 (Tex. App.–Houston [14th Dist.] 1989, writ denied). *See also* annotations to Sections 4.1(b) and (d) (Representations and Warranties of Guarantor), *infra*, and second annotation on the Signature Page to this Guaranty, *infra*. Under article 1302-2.06B, the decision of, or decision made pursuant to authority granted by the board of directors of, the guarantor corporation that the guaranty may reasonably be expected to benefit, directly or indirectly, the guarantor corporation, is binding upon the guarantor corporation. Further, no guaranty made by a corporation in accordance with the statutory provisions is invalid or unenforceable as against such corporation unless the guaranty is sought to be enforced by a person who participated in a fraud on the guarantor corporation that resulted in the making of the guaranty, or by a person who had notice of such fraud before acquiring rights under the guaranty. *See* TEX. BUS. ORGS CODE ANN. § 2.104 (West 2010). Additionally, a guaranty will be considered to benefit a guarantor corporation if the guaranty guarantees a contract, security or other obligation of any subsidiary or affiliate of the guarantor corporation. *See id.* § §1.002(85), 2.104.

An issue to consider is the effect, if any, on a guaranty where (i) the guarantor corporation and the borrower share one or more officers or directors, or (ii) one or more officers or directors of the guarantor corporation have a

D. In connection with the foregoing, Guarantor desires to guarantee to Lender the prompt and full payment and performance of the Guaranteed Indebtedness and the other Guaranteed Obligations, upon the terms and conditions contained in this Guaranty.

STATEMENT OF AGREEMENTS

For good and valuable consideration,[7] the receipt and sufficiency of which are hereby acknowledged and confessed, and as a material inducement to Lender to enter into the Loan Documents and to make the Loan, or otherwise extend credit, to Borrower, Guarantor hereby guarantees to Lender the prompt and full payment and performance of the Guaranteed Indebtedness and the other Guaranteed Obligations upon the following terms and conditions:

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financial interest in the contract or obligation being guaranteed. The Texas Business Organizations Code sets forth the standard when a contract or transaction is valid notwithstanding that one or more officers or directors are common between the guarantor and borrower corporations or have a financial interest in the underlying contract or transaction. If the material facts are disclosed and if either (1) the board of directors in good faith approves the transaction by affirmative vote of the majority of the disinterested directors, or (2) the shareholders entitled to vote authorize the transaction in good faith, the contract or transaction is valid. *See* TEX. BUS. ORGS CODE ANN. § 21.418 (West 2010). Common or interested directors may be counted for determining the presence of a quorum at a meeting of the board of directors. *See id.* § 21.418. This should be of particular concern only in transactions where the guaranty guarantees a contract or obligation of an entity that is not a subsidiary or affiliate of the guarantor corporation for purposes of § 2.104 of the Texas Business Organizations Code.

The "consideration" received by a guarantor for the obligations incurred under a guaranty could also raise issues under state and federal law that allow certain creditors to avoid transfers or recover property when such transfers are considered "fraudulent transfers." Under section 548(a)(1) of Title 11 of the United States Code (the "Bankruptcy Code"), a trustee may avoid a transfer made within two years of the petition date if the debtor in bankruptcy either: (1) made such transfer *or incurred such obligation* with actual intent to hinder, delay or defraud any then existing or future creditor of the debtor; or (2) (A) received less than a reasonably equivalent value in exchange for such transfer or obligation and (B) (i) was insolvent on the date that such transfer was made or such obligation was incurred, or became insolvent as a result of such transfer or obligation, (ii) was engaged in or was about to engage in business or a transaction for which the debtor's remaining capital was unreasonably small, or (iii) intended to incur, or believed that it would incur, debts that would be beyond its ability to pay as such debts matured. *See* 11 U.S.C. § 548 (2009) [emphasis added]. Thus, transfers or obligations that are actually fraudulent or constructively fraudulent may be avoided.

Section 544 of the Bankruptcy Code also allows a trustee to use state fraudulent transfer statutes to avoid fraudulent transfers. *See* 11 U.S.C. § 544 (2009). Although state fraudulent transfer statutes are generally very similar to section 548(a)(1) of the Bankruptcy Code, state laws often allow the trustee a longer look-back period (commonly four years instead of two). *See, e.g.,* TEX. BUS. & COM. CODE ANN. §§ 24.001-24.011 (West 2010).

In most fraudulent transfer cases, the cases focus on the concept of "reasonable equivalent value," which is not defined by the Bankruptcy Code or most state statutes. To determine whether a guarantor received reasonable equivalent value in exchange for its guaranty, a bankruptcy court will weigh the value of the property received by the guarantor against the value transferred by the guarantor. *See* In re Besing, 981 F.2d 1488, 1495 (5th Cir. 1993). In the Fifth Circuit, the inquiry is fact-intensive based upon the totality of the circumstances rather than a purely mathematical analysis. *See id*. In order to equal reasonable equivalent value, these amounts need not be exact mathematical equivalents. *See* In re Southmark Corp., 138 B.R. 820, 829 (N.D. Tex. 1992).

[7] *See* annotations to Paragraphs B.and C. in the Recitals to this Guaranty, *supra*.

ARTICLE I
DEFINITIONS

1.1 Definitions.[8] As used in this Guaranty, the following terms have the following meanings:

Affiliate: As to any Person, any other Person that directly or indirectly (a) through one or more intermediaries, controls or is controlled by, or is under common control with, such Person, (b) beneficially owns or holds an ownership interest in such Person, or (c) is owned, or an ownership interest in such other Person is held, in whole or in part, by the Person in question. For purposes hereof, the term "control" means the possession, directly or indirectly, of the power to direct or cause direction of the management and policies of a Person, whether through the ownership of voting securities, partnership interests, membership interests, venture interests or other organizational interests, by contract, or otherwise; provided, however, in no event shall Lender be deemed an Affiliate of Borrower or any Guarantor.[9]

Borrower: ______________________________, a _________________, together with and including any and all Persons that are its successors or assigns, regardless of whether any such successor or assign is formed by or results from any merger, consolidation, conversion or reorganization of the above-named Borrower or of any Person that is the above-named Borrower's successor or assign, or any sale, transfer, conveyance or acquisition of title or ownership interest of or in the Mortgaged Property or other assets, by the above-named Borrower or any Person that is the above-named Borrower's successor or assign, or otherwise,

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[8] This Guaranty incorporates all defined terms in this Section 1.1 (Definitions) for ease of reference for Guarantor, Lender and their respective counsel in reviewing this document. This enables the reader to easily find the definition for a capitalized term without having to review the entire document to find such definition. This Guaranty also contains Riders that address various optional or additional provisions. If a Rider is incorporated into the body of the Guaranty, the definitions contained in that Rider should be incorporated into this Section 1.1.

[9] Awareness of affiliate transactions and the persons that may constitute affiliates is important in loan transactions that include a guaranty. This definition is one commonly used by lenders and is important because a prudent lender must be aware of, and may want to limit, transactions among affiliates that may be on terms less favorable to the guarantor than those at arm's-length with independent third-parties. Other definitions are also available, and may be appropriate in particular circumstances. For example, the SEC definition of an affiliate could be used: "Affiliate" of a specified person means (i) a person that owns, controls, or holds with power to vote, more than five percent (5%) of the outstanding voting securities of the specified person, (ii) a company of whose outstanding voting securities the specified person owns, controls, or holds with power to vote, more than five percent (5%), (iii) a person controlling, controlled by, or under common control with, the specified person, (iv) a director, officer, or partner of the specified person, (v) an employee of the specified person, (vi) an investment adviser, or member of an advisory board, of the specified person if the specified person is an investment company, or (vii) the sponsor of the specified person if the specified person is an investment company without a board of directors. *See* FED. SEC. CODE § 202(3)(A) & (B) (ALI 1980). Some lenders, borrowers or guarantors may desire to use a control concept found in GAAP: An "affiliate" of, or a person "affiliated" with, a specific person is one that directly, or indirectly through one or more intermediaries, controls, or is controlled by, or is under common control with, the person specified. *See* Codification of Accounting Standards and Procedures, Statement of Financial Accounting Standards No. 57 (Financial Accounting Standards Bd. 2008).

and further including Borrower as a debtor-in-possession and any Person hereafter appointed for Borrower or all or substantially all of Borrower's assets under any Debtor Relief Law.[10]

Charges: All fees, charges and other things of value, if any, contracted for, charged, received, taken or reserved by Lender in connection with the transactions relating to the Note and the Loan Documents, which are treated as interest under applicable law.[11]

Debtor Relief Laws: Title 11 of the United States Code[12], as now or hereafter in effect, or any other applicable law, domestic or foreign, as now or hereafter in effect, relating to bankruptcy, insolvency, liquidation, receivership, reorganization, arrangement or composition, extension or adjustment of debts, or other debtor relief, or similar laws affecting the rights of creditors.

Deed of Trust:[13] That certain Deed of Trust of even date herewith executed by Borrower, as grantor, to ___________, as trustee, for the benefit of Lender, as beneficiary, relating to the Mortgaged Property, as such Deed of Trust may hereafter be amended, modified, supplemented, restated, extended or renewed and in effect from time to time.

Default:[14] The occurrence of any default or event of default under, and as defined in, this Guaranty, the Note, the Deed of Trust or any of the other Loan Documents, and further including

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[10] The definition of "Borrower" should be expansive enough to include successors by merger or consolidation. A loan agreement or deed of trust will normally prohibit a borrower from transferring the mortgaged property, merging, selling its assets or any interest in the borrower or dissolving. If a borrower breaches these covenants or files for bankruptcy, lender may demand payment from a guarantor pursuant to Section 2.3(b) (Primary Liability of Guarantor), *infra*, and the guarantor may assert that it is responsible only for the debts of the original borrower, which entity may no longer legally exist. The breadth of this definition is intended to prevent a guarantor from successfully asserting that position. *See* Chambers v. NCNB Tex. Nat'l Bank, 841 S.W.2d 132, 134, (Tex. App.–Houston [14th Dist.] 1992, no writ). *See also* Zinnecker, Lawyers Who Draft and Negotiate Guarantees (and the Clients Who Love Them).

[11] *See* definition of "Maximum Lawful Rate" and the annotation thereto in this Section 1.1 (Definitions), *infra*.

[12] 11 U.S.C. § 1 *et seq*. (2009).

[13] *See generally,* Edward A. Peterson and John M. Nolan, Annotated Document Series, presented at the 29TH ANNUAL ADVANCED REAL ESTATE LAW COURSE (2007). The Texas Annotated Deed of Trust is referred to in the annotations to this Guaranty as the "Annotated Deed of Trust," and the Texas Annotated Promissory Note is referred to in the annotations to this Guaranty as the "Annotated Promissory Note."

[14] A "Default" triggers the rights of a lender to pursue the remedies available to the lender under a guaranty (such as to require payment and performance by a guarantor of the guaranteed obligations) and under the other loan documents (such as acceleration of the debt, and foreclosure of any liens and security interests covering the mortgaged property). *See* Annotated Promissory Note (as referenced in the annotation to the definition of "Note" in this Section 1.1 [Definitions]), annotations to Section 3.1 (Event of Default) and Section 3.2 (Remedies), for a more detailed analysis of certain events constituting a Default under the Loan Documents and the remedies available to Lender upon a Default. *See also* Annotated Deed of Trust, Article VII (Remedies) for a general discussion of various remedies available to Lender. Such events of "default" in a guaranty should be consistent in language and scope with those set forth in the other loan documents (*e.g.*, the insolvency or bankruptcy of the guarantor,

any of the following: (i) Guarantor's failure to pay or perform any of the Guaranteed Obligations in strict accordance with the terms hereof; (ii) any statement, representation or warranty made by or on behalf of Guarantor in or under this Guaranty or any other Loan Document, or in any report, certificate, financial statement or any other instrument heretofore or hereafter delivered or furnished to Lender by Guarantor in connection with the Loan, is false, fraudulent, misleading or erroneous in any material respect on the date hereof or on the date as of which such statement, representation or warranty is made, or the falsity in any material respect of, or any material omission in, any representation made by Guarantor to Lender; (iii) any violation, breach or default by Guarantor of any term, covenant, condition, representation or warranty under this Guaranty or of any obligation of Guarantor under this Guaranty **[(including, without limitation, Guarantor's failure to comply with the financial covenants set forth in Section 4.3 hereof)]**;[15] (iv) the **[*for individual:* death, incompetency] [*for entity:* dissolution]** or insolvency of Guarantor;[16] (v) the inability of Guarantor to pay, or Guarantor's failure to pay, debts

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misrepresentations by the guarantor, any breach of a covenant or warranty by the guarantor under the guaranty, etc. should also be listed as an event of default in the deed of trust or loan agreement). The preferred practices are to (i) include a comprehensive list of defaults in one of the other loan documents (typically in the loan agreement or deed of trust), and to specifically make reference in the guaranty to the default provisions in the loan agreement or deed of trust so that no inconsistency or ambiguity exists (*i.e.*, a "cross-default" clause, which incorporates as a "default" under the guaranty any default or event of default under any of the other loan documents), and (ii) add other defaults that may be particular to the guaranty or the guarantor. The events constituting a Default described in this definition are not intended to be all inclusive or exclusive, and may be expanded or reduced as deemed appropriate by the particular lender or with respect to a particular loan. Also note that a failure to perform may be subject to either a grace period (which is a fixed time period without the requirement of notice from lender) or a notice and cure period (which is a fixed time period after the lender has provided oral or written notice to the borrower or the guarantor, as applicable, of such failure to perform) within which the borrower or the guarantor, as applicable, may satisfy or "cure" such failure or nonperformance before it constitutes a default.

[15] *See* Rider 3 (Specific Financial Covenants), *infra*, for examples of covenants to incorporate into Section 4.3 (Financial Covenants). Some lenders may determine that a guarantor's failure to comply with a specific financial covenant should be a default under the guaranty and the other loan documents, while other lenders may decide that such compliance should only be a condition to further advances under the loan.

[16] Some lenders may agree (typically in the loan agreement or deed of trust) that the death of an individual guarantor, or the dissolution of a corporation, partnership or limited liability company guarantor, will not constitute a default under the loan so long as (i) there still remains one or more other creditworthy guarantors, and (ii) the borrower replaces the deceased or dissolved guarantor with a substitute guarantor acceptable to lender within a certain period of time (such as 60 days) following the date of such death or dissolution. A lender will often require in the loan documents that any substitute guarantor satisfy specified underwriting criteria, such as a certain level of liquidity or net worth, in order to be acceptable to lender.

In lieu of requiring a substitute guarantor, a lender may accept, in the case of the death of an individual guarantor, an affirmation from the decedent's estate or the probate court that the obligations of such decedent under the guaranty are binding upon the estate (provided that the estate has sufficient assets). In addition, a lender will typically expressly state that the guarantor waives any defense that may arise by reason of the incapacity, lack of authority, death or disability of the guarantor (including the failure of the lender to file or enforce a claim against the guarantor's estate in administration, bankruptcy or any other proceeding). Provisions incorporating these concepts can be found in this Guaranty. *See also* second annotation to Section 6.3 (Binding Effect), *infra*.

Similarly, instead of providing that the death or incapacity of the guarantor is a default, some lenders make the guaranty expressly binding on the heirs, personal representatives (or successors and assigns) of the guarantor. At generally as they become due; (vi) an assignment by Guarantor for the benefit of creditors;[17] (vii) the filing of a petition or the institution of any proceeding or action by or against any Guarantor pursuant to any Debtor Relief Law;[18] (viii) the determination by Lender in good faith

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least one court, however, has held that such provisions fail to create a binding obligation on the heirs, successors or assigns of the guarantor due to lack of privity. In Jefferson State Bank v. Seguin Hotel Corp. (In re Seguin Hotel Corp.), no. 09-53355-C, 2010 WL 2900426 (Bkrtcy. W.D. Tex., July 20, 2010), a guarantor executed a guaranty that expressly provided that the guaranty would be binding upon guarantor's heirs, successors and assigns. After the guarantor died, the lender brought suit against the heirs of the guarantor's estate, claiming that the heirs were liable to the bank "in their beneficiary capacity to the extent of the distribution they received from the Estate." The heirs argued, among other things, that although the guarantor's estate might be liable for the guarantor's obligations, "beneficiaries of a deceased guarantor do not automatically inherit the legal and contractual obligations of their ancestor". The court strongly agreed with this argument stating "Perhaps in another age, another millennium, when there were lords and serfs, the debts of the father could be visited on the sons and the grandsons and their heirs, forever holding the serfs in bondage to the lord of the manor. But not in this age." The court held that as a matter of law, the heirs were not liable for the guaranty of the loan because there was no privity between the heirs and the lender (citing House v. Houston Waterworks Co ., 88 Tex. 233, 31 S.W. 179, (Tex. 1895) and Weekes v. Sunset Brick & Tile Co., 56 S.W. 243, 247 (Tex.Civ.App.-Houston 1900). The court also rejected the language in the guaranty binding the heirs of the guarantor noting that "the fact that the guarantor signed a document *purporting* to bind his heirs is of no moment whatsoever. He had no authority to bind them, and nothing indicates that they volunteered to be liable as guarantors at any point in time."

[17] An *assignment for the benefit of creditors* is a specific remedy available to debtors under Texas law. Such an assignment is an absolute, unconditional, indefeasible, and irrevocable transfer of property, made for the purpose of paying debts out of the proceeds of the debtor's property. *See* Blum v. Welborne, 58 Tex. 157 (Tex. 1882). There are two types of assignments for benefit of creditors; one arising under statute, the other arising under common law. The statutory remedy is expressly granted by the Texas Business & Commerce Code. *See* TEX. BUS. & COM. CODE ANN. § 23.01 *et seq*. (West 2010). *See* Scott v. Nunn Elec. Supply Corp., 386 S.W.2d 891 (Tex. Civ. App.–Amarillo 1965). Under Texas statutes, an assignment for the benefit of creditors must be made in writing and must be proved or acknowledged and recorded in the manner provided by law for the conveyance of real estate. *See* TEX. BUS. & COM. CODE ANN. § 23.08(a) (West 2010). Additionally, the assigning debtor must attach to his assignment an inventory containing the following information: (i) a list naming each creditor of the assigning debtor; (ii) the resident address, if known, of each creditor; (iii) the amount owed each creditor and the type of debt; (iv) the consideration for the debt and the place where the debt arose; (v) a description of each existing judgment or security for the payment of the debt; (vi) a schedule of all the assigning debtor's real and personal estate at the date of the assignment; (vii) a description of each encumbrance on the real and personal estate and each voucher and security relating to the estate; and (viii) the value of the estate. *See id*. § 23.08(b). The validity of a common-law assignment for the benefit of creditors is governed by the law of contracts. *See* Weider v. Maddox, 1 S.W. 168 (Tex. 1886). Once effected, an assignment for the benefit of creditors conveys *all* real and personal property owned by the assigning debtor for distribution to consenting creditors (emphasis added). *See* Blum, 58 Tex. at 161; TEX. BUS. & COM. CODE ANN. § 23.02 (c) (West 2010).

[18] In addition to the remedies available to a creditor in dealing with a solvent debtor, every creditor must consider the effect of all Debtor Relief Laws when dealing with insolvent or potentially insolvent debtors. A voluntary petition under Title 11 of the United Stated Code (the "Bankruptcy Code") will halt a lender's collection efforts against the debtor that files such voluntary petition (whether such debtor is a borrower or a guarantor). *See* 11 U.S.C. § 362(a) (2009). As a general rule, the bankruptcy of a borrower will not affect the ability of the lender to pursue a guarantor, and the bankruptcy of a guarantor will not affect the ability of the lender to pursue the borrower. The automatic stay under section 362 of the Bankruptcy Code, which generally prevents any collection efforts against a debtor or its property during the pendency of a bankruptcy case, does not prevent a lender from pursuing a nondebtor, whether that person is a borrower or a guarantor. *See* 11 U.S.C. § 362 (2009). Notwithstanding this general rule, a debtor may request that the stay be extended to non-debtor parties (including guarantors) through what is commonly called a "Section 105 injunction." In re Zale Corp., 62 F.3d 746 (5th Cir. 1995); In re Otero Mills, Inc., 21 B.R. 777 (Bankr. D. N.M. 1982). Also, the discharge of a debtor, which generally discharges the personal

that a Material Adverse Change has occurred;[19] (ix) the entry of a **[judgment against Guarantor which has a Material Adverse Effect] [judgment or judgments against Guarantor exceeding $_________ in the aggregate which are not discharged or bonded to Lender's satisfaction within a period of ____ days after entry thereof]**, or the issuance of any writ or order of attachment,[20] levy[21] or garnishment[22] against Guarantor **[which has a Material Adverse Effect] [in connection with a judgment or judgments against Guarantor exceeding $________ in the aggregate which are not discharged or bonded to Lender's satisfaction within a period of ____ days after entry thereof]**; or (xi) any transfer of assets of any Guarantor without Lender's prior written consent, except for transfers of assets for estate planning purposes valued at less than $_________ per year per Guarantor, customary political and charitable contributions, and transfers for which Guarantor receives consideration (in the form of cash or other physical asset) substantially equivalent to the fair market value of the transferred asset.

Default Interest Rate: The rate of interest specified in the Note to be paid by Borrower from and after the occurrence of a Default under the provisions of the Note and Loan Documents, but in no event in excess of the Maximum Lawful Rate.[23]

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liability of the debtor and acts as a permanent injunction against collection of such liability, generally does not affect a nondebtor's liability. *See* 11 U.S.C. § 524(e) (2009).

[19] *See* annotations to the definitions of "Material Adverse Change" and "Material Adverse Effect" in this Section 1.1 (Definitions), *infra*.

[20] Attachment is a judicial remedy available to an unsecured creditor seeking control of assets of a debtor that may be secreted or disposed of by the debtor. Sections 61.001 through 61.063 of the Texas Civil Practice and Remedies Code and Rules 592 through 609 of the Texas Rules of Civil Procedure set forth the circumstances in which attachment may be available. *See* TEX. CIV. PRAC. & REM. CODE ANN. § 61.001-61.063 (West 2010); TEX. R. CIV. P. 592-609 (West 2010). *See also* second annotation to Section 2.3(b) (Primary Liability of Guarantor), *infra*.

[21] A sheriff's sale is a procedure available to creditors for disposal of assets of the debtor by way of levy and execution in enforcement of a judgment. Rules 621 through 656 of the Texas Rules of Civil Procedure set forth the procedures for execution on property in satisfaction of a judgment. *See id.* rules 621-656. Also note that Section 9.609 of the UCC allows secured parties to take possession of personal property collateral nonjudicially upon a default if possession is accomplished without a breach of the peace. *See* TEX. BUS. & COM. CODE ANN. § 9.609 (West 2010). *See also* second annotation to Section 2.3(b) (Primary Liability of Guarantor), *infra*.

[22] Garnishment is a judicial remedy available to a creditor seeking assets of a debtor held by a third party, the garnishee. Sections 63.001 through 63.006 of the Texas Civil Practice and Remedies Code and Rules 657 through 679 of the Texas Rules of Civil Procedure set forth the specific circumstances in which garnishment may be available. *See* TEX. CIV. PRAC. & REM. CODE ANN. §§ 63.001-63.006 (West 2010); TEX. R. CIV. P. 657-679 (West 2010). *See also* second annotation to Section 2.3(b) (Primary Liability of Guarantor), *infra*.

[23] This definition is incorporated into this Guaranty because, under certain provisions in this Guaranty, Guarantor may be required to pay interest on the amounts due and owing under the Loan Documents at the Default Interest Rate. *See* Annotated Promissory Note, Section 1.1 (Definitions) and Section 4.3 (Interest Provisions), for a discussion of this term and usury concerns. *See also* annotation to definition of "Maximum Lawful Rate" in this Section 1.1 (Definitions), *infra*, annotation to clause (D) of Section 3.1(a)(xv) (Certain Agreements and Additional Waivers by Guarantor), *infra*, annotation to Section 6.6 (Attorneys' Fees and Costs and Collection), *infra*, and

[Environmental Indemnity Agreement: That certain Environmental Indemnity Agreement of even date herewith executed by Borrower and _________, as indemnitor, for the benefit of Lender.]

GAAP: Generally accepted accounting principles, applied on a consistent basis, as set forth in Opinions of the Accounting Principles Board of the American Institute of Certified Public Accountants or in statements of the Financial Accounting Standards Board or their respective successors and which are applicable in the circumstances as of the date in question. Accounting principles are applied on a "consistent basis" when the accounting principles applied in a current period are comparable in all material respects to those accounting principles applied in a preceding period.[24]

Guaranteed Indebtedness:[25] Collectively, (i) all principal, interest, fees, attorneys' fees, commitment fees, late charges, costs, expenses, indemnification indebtedness, and all other

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annotation to Section 6.17 (Controlling Agreement), *infra*, for discussions relating to usury in the context of a Guaranty.

[24] Although the GAAP method of accounting can be used for individual guarantors, it is traditionally not the method chosen for some very practical reasons. GAAP implies an accrual method of accounting in which income and expenses are recorded on the books for the fiscal period in which they are earned or incurred, regardless of whether the income was actually received or expenses actually paid in the period. GAAP, however, also encompasses other revenue recognition methods, such as percentage-of-completion, completed-contract and installments methods. *See* Allan B. Afterman, GAAP PRACTICE MANUAL 73-2 (Warren, Gorham & Lamont 1985) (Supp. 1997). This contrasts with the cash basis of accounting where income and expenses are recorded only when actually received or paid out in the period. *See* THORDIKE ENCYCLOPEDIA OF BANKING AND FINANCE 16 (8th ed. 1980). The accrual method is likely too complicated and too expensive for individuals to maintain. Some individual guarantors may elect to use the GAAP method, but because of its greater complexity, the cash method is more often used.

A number of smaller companies and most individuals use one of the bases of accounting commonly referred to as "other comprehensive bases of accounting" or OCBOA. As one author notes, OCBOA are not identified or described in the accounting literature and the only authoritative reference comes from auditing literature in SAS 62. *See* Afterman, GAAP PRACTICE MANUAL 73-2. Generally, OCBOA include a *regulatory basis* (used, for example by insurance companies regulated by state insurance commissions), *income tax basis*, *cash or modified cash basis* (cash receipts and disbursements basis of accounting, possibly with some modifications such as tax accrual and depreciation on fixed assets) and *other bases* (those with a definite set of criteria and widespread support). The income tax and cash or modified cash bases are the most common OCBOA. *Id.* at 73-1.

[25] Note the inclusive nature of this definition. In addition to the principal amount of the Note and any interest accrued and payable on the Note, all other amounts payable by Borrower to Lender under any of the Loan Documents are included as part of the Guaranteed Indebtedness. Further, clauses (ii) and (iii) in this definition provide that future advances made by Lender to Borrower are also included as part of the Guaranteed Indebtedness. Finally, clauses (i)(b), (ii) and (iii) in this definition are intended to create a *continuing* guaranty by stating that (i) this Guaranty will be unaffected by any modifications, supplements, substitutions, refinancings, extensions, renewals, rearrangements or amendments of any of the Loan Documents, (ii) this Guaranty will apply to any increases in the amounts owed by Borrower to Lender and to any future advances made by Lender, and (iii) no amendment of this Guaranty will be necessitated by the foregoing. *See* third annotation to Section 2.1 (Guaranty of Payment), *infra*, for discussion of continuing guaranties, and annotation to Section 3.1(a)(viii) (Certain Agreements and Additional Waivers by Guarantor), *infra*, for further discussion of Guarantor's waiver of defenses with respect to modifications, amendments and the like.

indebtedness, liabilities and sums of money now or hereafter due or owing, or for which Borrower is liable or otherwise obligated to pay, pursuant to or arising under (a) the terms of the Note, the Deed of Trust or any of the other Loan Documents, and including, without limitation, any indemnity obligations contained in the Loan Documents, now or hereafter existing or arising, and (b) any and all renewals, modifications, increases, substitutions, refinancings, future advances, supplements, amendments, rearrangements or extensions of such indebtedness, or of any of the Loan Documents, or any part thereof, including any increases in the principal amount of the Note or in other amounts owed by Borrower to Lender under the Loan Documents, and any future or subsequent advances made by Lender to Borrower under the Loan Documents; (ii) all liabilities of Borrower for future advances, extensions of credit, sales on account or other value at any time given or made by Lender to Borrower arising under the Loan Documents, whether or not any such advances, credit, sales or value is given pursuant to a commitment of Lender; (iii) any and all other indebtedness, of every kind and character, of Borrower to Lender now or at any time hereafter existing, created or arising under the Loan Documents or in connection with the Loan, regardless of whether such present or future indebtedness be direct or indirect, related or unrelated, liquidated or unliquidated, primary or secondary, joint, several, or joint and several, or fixed or contingent; (iv) any and all interest and expenses (including attorneys' fees) arising under the Loan Documents whether or not allowed under any Debtor Relief Law (including all post-petition interest accruing after the commencement of any bankruptcy or insolvency proceeding by or against Borrower, whether or not allowed in such proceeding), and all other amounts that would be part of the indebtedness but for the operation of Debtor Relief Laws;[26] and (v) all costs, expenses and fees, including, without limitation, court costs and attorneys' fees, arising in connection with the collection of any or all amounts, indebtedness, obligations and liabilities of Borrower to Lender described in clauses (i) through (iv) of this definition.

[*See Rider 1 for Limitations of Guaranteed Indebtedness.*][27]

[26] After a borrower files bankruptcy an under-secured lender may not collect post-petition interest from the borrower. Section 502(b)(2) of the Bankruptcy Code provides for the implementation of this principle. The majority of courts interpret section 502(b)(2) to allow (i) interest to continue to accrue post-petition on pre-petition debts, and (ii) collection of this interest from a guarantor, but prohibit the charging of interest against the borrower's bankruptcy estate. *See* In re El Paso Ref., Inc., 192 B.R. 144, 146 (Bankr. W.D. Tex. 1996); In re Heron, 148 B.R. 660, 670 (Bankr. D.C. 1992). A minority of other courts have held that interest ceases to accrue on the filing of a bankruptcy petition. *See* In re Hart Ski Mfg. Co., 7 B.R. 465, 469 (Bankr. D. Minn. 1980). The practical result of the majority rule allows the collection of interest from a non-debtor guarantor notwithstanding the bankruptcy of the borrower. *See* In re El Paso Ref., Inc., 192 B.R. at 146; United States v. Bruno, 747 F.2d 53 (1st Cir. 1984) (holding the guarantor liable for post-petition interest where the guaranty contained a provision stating that guarantor's liability would not be affected by borrower's bankruptcy). Notwithstanding Section 502(b)(2), a lender can charge and collect post-petition interest under the loan documents if its claim is over-secured. *See* 11 U.S.C. § 506(b) (2009).

[27] Rider 1 (Limitations of Guaranteed Indebtedness), *infra*, incorporates various examples of limitations on the amount or type of Guaranteed Indebtedness for which Guarantor is liable under the Guaranty. For example, Lender may agree to limit the amount of principal under the Note guaranteed by Guarantor, or Lender may allow Guarantor's liability with respect to certain portions of the Guaranteed Indebtedness to "burn off" or be reduced after the satisfaction of certain conditions and criteria.

Guaranteed Obligations: Collectively, the Guaranteed Indebtedness and all other obligations, duties and liabilities of Borrower under the Loan Documents.[28] The Guaranteed Obligations shall include without limitation, the timely payment of all taxes and assessments due and payable in connection with the Mortgaged Property, and the maintenance of all insurance and the timely payment of all premiums thereon, in strict accordance with the terms of the Deed of Trust and the other Loan Documents.

[*See Rider 2 for Additional Construction Loan Performance Obligations.*][29]

[Interest Rate Protection Agreement: An interest rate swap agreement, International Swaps and Derivatives Association, Inc. (ISDA) Master Agreement or other similar agreement or arrangement entered into by Borrower and Lender from time to time to hedge the risk of variable interest rate volatility or fluctuations of interest rates, and any and all documents, schedules and confirmations related thereto (as any such agreement or arrangement or other documents, schedules or confirmations may at any time be renewed, extended, supplemented, increased or modified and in effect from time to time.)][30]

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[28] This term reflects the full extent of Guarantor's liability under this Guaranty, which includes both the payment of all indebtedness of Borrower to Lender under the Loan Documents and the payment and performance of all other obligations, duties and liabilities of Borrower under the Loan Documents. *See* annotations to the definition of "Guaranteed Indebtedness" in this Section 1.1 (Definitions), *supra*. This definition of Guaranteed Obligations is intended to encompass all obligations of Borrower to Lender under the Loan Documents, including the performance of all obligations of Borrower under the Loan Documents not included within the definition of Guaranteed Indebtedness. Such obligations may include, for example, paying all taxes related to the Mortgaged Property, maintaining casualty and general liability insurance coverage for the Mortgaged Property, paying all bills for materials and services relating to the Mortgaged Property, keeping the Mortgaged Property free from liens (other than the liens held by Lender), making repairs necessary to keep the Mortgaged Property in first-class order and condition, and maintaining and operating the Mortgaged Property in compliance with all applicable Laws. *See* Annotated Deed of Trust, Articles IV and V (Affirmative Covenants and Negative Covenants), for a more extensive list of Borrower's obligations and duties. A Deed of Trust generally grants Lender the right to perform any covenant that Borrower fails to keep or perform and further provides for reimbursement of all costs so incurred by Lender. *See* Annotated Deed of Trust, Section 7.1(a) (Right to Perform Grantor's Covenants). Pursuant to clause (i) of the definition of "Guaranteed Indebtedness" in this Section 1.1 (Definitions), *supra* (which includes all amounts for which Borrower is liable or otherwise obligated to pay pursuant to the terms of the Deed of Trust), Guarantor is also liable for any such costs incurred by Lender.

[29] Rider 2 (Additional Construction Loan Performance Obligations), *infra*, incorporates several provisions typically found in a construction loan guaranty where there is a construction loan agreement between a borrower and a lender setting forth certain conditions to construction advances and other standards, requirements and criteria to be complied with by the borrower with respect to completion of improvements. Accordingly, Rider 2 adds to the term "Guaranteed Obligations" specific covenants and obligations with respect to construction, as well as various examples of limitations on the guarantor's liability for such additional construction obligations. For example, a lender may agree to an upfront limitation on the guarantor's liability for construction of the improvements, or allow the guarantor's liability with respect to completion of the improvements to "burn off" after the satisfaction of certain conditions (*e.g.*, such as upon substantial completion of, and obtainment of a certificate of occupancy for, "shell" improvements).

[30] Most traditional permanent loans accrue interest at a fixed rate, which many borrowers elect because it provides certainty. A borrower desiring certainty, but faced with the prospect of a variable interest rate loan, may be able to achieve substantially the same benefit as with a fixed interest rate by availing itself of one of the interest rate

Land: The "Land" described in the Deed of Trust.[31]

Law: Any federal, state or local law, statute, code, ordinance, order, rule or regulation, including judicial opinions or precedential authority in the applicable jurisdictions.[32]

Litigation: Any judicial, administrative, mediation or arbitration actions, disputes, claims, controversies, suits or proceedings, whether in contract or tort, legal or equitable, or pursuant to any Law, before any Tribunal.

Loan: The loan from Lender to Borrower in the stated principal amount of ________________ and No/100 Dollars ($_______________) evidenced by the Note and governed and secured by the Deed of Trust and the other Loan Documents.[33]

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protection products commonly available today (such as swaps, caps, collars and the like). *See* Annotated Promissory Note, Section 2.1 (Payment of Principal and Interest) and Rider 2 (Alternative Rate Options), for a discussion of various interest rate options available to a borrower.

While a full discussion of interest rate protection products is beyond the scope of this presentation, a few brief comments are illustrative. In common parlance, a "swap" is the trading of one type of rate (floating, for example) with another type (fixed, for example); a "cap" limits the upper level of a floating rate; and a "collar" establishes a minimum and maximum rate at which interest could accrue.

The International Swaps and Derivatives Association (the "ISDA") has promulgated standard forms that are used almost exclusively to document these types of products, which forms include the Master Agreement, Credit Support Annex and related Schedules and Confirmations. The Master Agreement, Credit Support Annex and related Schedules govern the basic terms of the transaction and Confirmations contain the terms of each specific transaction. These documents allow the borrower and lender to allocate risk of rising interest rates to the lender in exchange for payment of a fee. If interest rates drop, the borrower will be obligated to pay additional amounts to the lender and may have to post a substantial amount of cash or treasury bonds as collateral during the term of the swap. A borrower may also owe termination payments if a swap or other interest rate protection product is terminated early. Depending on the particular interest rate environment, a borrower's swap obligations can approach, or even exceed, the borrower's liability on the underlying loan transaction. Therefore, despite any lien securing performance of the borrower's obligations, a borrower is often required to provide some type of credit enhancement due to these increased risks. Thus, a guarantor is often required to guarantee the borrower's swap obligations as additional protection to the lender against such risks and to cover these potential expenses of the borrower.

Accordingly, the definition of "Guaranteed Obligations" in this Section 1.1 (Definitions), *supra*, includes the obligations of Borrower under all of the Loan Documents, which includes any Interest Rate Protection Agreement. *See* definition of "Loan Documents" in this Section 1.1 (Definitions), *infra*. A full risk analysis should be performed in connection with each proposed transaction and extreme care should be taken before accepting the perceived benefits of an interest rate protection product.

[31] The definition of "Land" in the Deed of Trust should be broad and designed to include all items appurtenant to Borrower's real property that is security for the Loan. *See* definition of "Land" in Annotated Deed of Trust, Section 1.1 (Definitions).

[32] "Law," in its generic sense, is a body of rules of action or conduct duly prescribed by controlling authority, and having binding legal force. *See* U.S. Fid. and Guar. Co. v. Guenther, 281 U.S. 34 (1930). A law is that which must be obeyed and followed by citizens subject to sanctions or legal consequences. *See also* annotations to Section 6.4 (Governing Law; Submission to Jurisdiction), *infra*.

[Loan Agreement: That certain Loan Agreement dated of even date herewith by and between Lender and Borrower, as such agreement may hereafter be modified, supplemented, restated, extended, amended or renewed and in effect from time to time.][34]

Loan Documents: This Guaranty, the Note, the Deed of Trust, **[the Loan Agreement,] [the Environmental Indemnity Agreement,] [any Interest Rate Protection Agreement,]** any assignment of rents, any other indemnity or guaranty agreement, any financing statements, and such other agreements,[35] documents and instructions now or hereafter evidencing, governing, securing or guaranteeing any portion of the Guaranteed Indebtedness or Guaranteed Obligations or executed by Borrower, Guarantor or any other Person in connection with the Loan or in connection with the payment of any portion of the Guaranteed Indebtedness or the performance and discharge of any of the Guaranteed Obligations, together with any and all renewals, modifications, amendments, restatements, consolidations, substitutions, replacements, extensions and supplements hereof or thereof.

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[33] This Guaranty is primarily intended for use in a real estate permanent loan made for the purpose of Borrower acquiring or refinancing an existing, completed project. This Guaranty, however, incorporates optional, bolded language for use with a construction loan whereby the proceeds of the loan are being utilized by a borrower for the acquisition of land and the construction of improvements thereon. As previously noted, Rider 2 (Additional Construction Loan Performance Obligations), *infra*, also incorporates several provisions typically found in a guaranty for a construction loan, whereby the guarantor further guarantees specific obligations with respect to the completion of improvements.

[34] This Guaranty is primarily drafted for a permanent loan without use of a loan agreement. A loan agreement is typically not used in a permanent loan context where the entirety of the loan proceeds are advanced to the borrower at the time of closing the Loan. With a permanent loan, where the proceeds are used to acquire an existing project, lenders often incorporate all representations, warranties and covenants otherwise found in a loan agreement into the deed of trust. This obviously must tie to the preferences of the client. A loan agreement is generally needed only for loans made in multiple advances or "draws" to the borrower upon satisfaction of various conditions. For example, with a construction loan, multiple advances will be made throughout the period of construction. A loan agreement governing the disbursement of loan proceeds for the construction or rehabilitation of improvements would require that certain conditions be satisfied for each draw, such as no existing default under the loan, proper lien waivers submitted to lender, construction to-date completed in accordance with the loan agreement and all applicable laws, and other standard or special conditions as lender may require.

[35] Depending on the type of loan transaction involved (*e.g.*, whether permanent or construction related), and the particular business terms of the loan, the documents to be signed by the borrower will vary. *See, e.g.*, annotation to definition of "Loan Agreement" in this Section 1.1 (Definitions), *supra*. The definition of "Loan Documents" should be inclusive as to all documents executed or that may be executed by Borrower in connection with the Loan in order to ensure that all of Borrower's obligations under such documents are captured within the definition of the "Guaranteed Obligations." If there is any chance that Borrower will execute an Interest Rate Protection Agreement, then it should be included in the definition of "Loan Documents." Failure to do so will likely exclude Borrower's obligations under the Interest Rate Protection Agreement from the definition of "Guaranteed Indebtedness."

Material Adverse Change: Any event, circumstance, fact, condition, development or occurrence that has had or could be expected to have a Material Adverse Effect.[36]

Material Adverse Effect: Any material and adverse effect on (i) the business, condition (financial or otherwise), operations, prospects, liabilities, assets, results of operations, capitalization, liquidity or any properties of Guarantor or of any subsidiary of Guarantor, taken as a whole, (ii) the ability of Guarantor **[or any Persons comprising Guarantor]** to pay and perform the Guaranteed Indebtedness and the other Guaranteed Obligations in strict accordance with the terms of this Guaranty, or (iii) the validity, enforceability or binding effect of this Guaranty or any of the Loan Documents.[37]

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[36] This Material Adverse Change ("MAC") definition is often used interchangeably with a Material Adverse Effect ("MAE") definition, but the two have been separated in this Guaranty for important purposes. A MAC is the result of some event or circumstance that would cause an MAE.

A MAE clause is often requested by borrowers and guarantors in order to provide some limitation or exception to otherwise absolute representations and warranties, while a MAC clause more customarily constitutes a default or condition precedent. While MAC and MAE clauses are often heavily negotiated in business or property acquisition transactions, there is less controversy in lending transactions. There are a variety of carve-outs and exceptions to MAE and MAC clauses depending upon the particular circumstances. The most frequent request is to delete the word "prospects," the negotiation of which can become contentious. *See* Rod J. Howard, Deal Risk, Announcement Risk and Interim Changes: Allocating Risks, Corporate Law and Practice Course Handbook Series, PLI Ord. No. BO-006x (Dec. 1999-March 2000). The controversial "prospects" clause is most often left in the document, but sometimes the provision is negotiated such that general industry or economic conditions not affecting the borrower or the guarantor in particular are excluded.

Note, however, that the standard of "materiality" is rarely defined. There are a number of cases that discuss materiality, but there is no general consensus. Most of the decided cases arise in the context of an acquisition. *See, e.g.*, Pan Am Corp. v. Delta Air Lines, Inc., 175 B.R. 438 (Bankr. S.D. N.Y. 1994) (holding a decline in advanced bookings for travel by between 19-43% was found to have resulted in a MAC); Esplanade Oil & Gas, Inc. v. Templeton Energy Income Corp., 889 F.2d 621 (5th Cir. 1989) (indicating that it was not clear whether a drop in the price of oil, from $28 to $20 per barrel, constituted a MAC in the target's properties or interests therein); ECL Indus., Inc. v. Ticor and S. Pac./Co., 1986 WL 9222 (S.D. N.Y. 1986) (holding, in denying a motion to dismiss, that a tax liability amounting to less than 1.9% of the purchase price of the company could be material, and rejecting the argument that the amount was too small to be material as a matter of law); Wilson v. Great Am. Indus., Inc., 661 F.Supp. 1555, 1563-64 (N.D.N.Y. 1987) (holding that a damage award equal to less than 3% of the corporation's assets was material). Among some commentators and practitioners there is a rule of thumb that 1% of gross revenues is a material amount. *See* Howard, Deal Risk, Announcement Risk and Interim Changes: Allocating Risks. There is at least one Texas case, Borders v. KRLB, Inc., 727 S.W.2d 357 (Tex. App.–Amarillo 1987, writ ref'd n.r.e.), that decided that an event (a decrease in arbitron ratings) was not within the scope of a MAC clause. However, the MAC clause found in the Borders case had such peculiar language and its context in the agreement was such that the decision limiting the effect of the MAC clause will probably not have much precedential value.

See also annotation to definition of "Material Adverse Effect" in this Section 1.1 (Definitions), *infra*.

[37] The question often arises as to the difference between a MAC and a MAE. To some extent it may really be a case of shorthand terminology (a number of agreements use both concepts without a definition of either). When the terms are not defined, the use of both can result in substantially different outcomes. For example, the realization of a risk may constitute a MAE, but arguably not a MAC, if the risk was something known to the parties prior to the execution of the agreement. Some sample clauses can be found in Michael J. Halloran & D. Stanley Rowland, Changes in Material Adverse Change Provisions in High Tech Deals, 10 M&A LAW 12 (March 1999).

Maximum Lawful Rate: The maximum lawful rate of interest which may be contracted for, charged, taken, received or reserved by Lender in accordance with the Laws of the State of Texas (or applicable United States federal Law to the extent that it permits Lender to contract for, charge, take, receive or reserve a greater amount of interest than under Texas Law), taking into account all Charges made in connection with the transaction evidenced by the Note and the other Loan Documents. To the extent that Lender is relying on Chapter 303 of the Texas Finance Code to determine the Maximum Lawful Rate payable on the Note or any other portion of the Guaranteed Indebtedness, Lender will utilize the weekly ceiling from time to time in effect as provided in such Chapter 303, as amended. To the extent United States federal Law permits Lender to contract for, charge, take, receive or reserve a greater amount of interest than under the Laws of the State of Texas, Lender will rely on United States federal Law instead of such Chapter 303 for the purpose of determining the Maximum Lawful Rate. Additionally, to the extent permitted by Law now or hereafter in effect, Lender may, at its option and from time to time, utilize any other method of establishing the Maximum Lawful Rate under such Chapter 303 or under other Law by giving notice, if required, to Borrower as provided by Law now or hereafter in effect.[38]

Ordinarily, MAE and MAC clauses require that materiality be measured on a consolidated basis, but in particular circumstances, it may be appropriate to measure materiality on some other basis, such as a MAE in connection with a particularly significant division or product or specific collateral.

Extreme care should be taken in including a phrase such as "taken as a whole" (see clause (i) of the MAE definition) because of unintended consequences. Should the provision be put at the end of the definition, an ambiguity could occur, and at least one author is aware of an instance in which litigators have argued that the phrase modifies other portions of the MAE clause (*i.e.*, "material adverse effect on the business, operations, assets, properties, results of operations and prospects . . . taken as a whole."). *See* Howard, Deal Risk, Announcement Risk and Interim Changes: Allocating Risks.

See also annotation to definition of "Material Adverse Change" in this Section 1.1 (Definitions), *supra*.

[38] The Texas Finance Code stipulates the permissible rates of interest in Texas. The maximum lawful rate or amount of interest is ten percent (10%) per annum, except as otherwise provided by law. *See* TEX. FIN. CODE ANN. § 302.001 (West 2010). Other Texas statutes provide alternative ceilings, the most significant of which, and most relevant to the real estate practitioner, are those optional rate ceilings found in Chapter 303 of the Texas Finance Code which provide for optional weekly, monthly, quarterly and annualized ceilings. These alternative ceilings are computed by the Texas Consumer Credit Commissioner in accordance with the provisions of Chapter 303 and published on a weekly basis. As of the date of this presentation, the maximum rate of interest permitted under Texas law pursuant to Chapter 303, applicable to each of the four alternative optional ceilings, is eighteen percent (18%) per annum (as to consumer and commercial loans, regardless of amount). United States federal law provides certain possible exceptions to the application of Texas statutes for determination of the Maximum Lawful Rate. For example, 12 U.S.C. § 85 (2009) of the National Bank Act provides an alternative maximum rate of interest that may be charged by national banks. Likewise, 12 U.S.C. § 1831(d) (2009) creates a "most favored lender" status for state-chartered insured depository institutions and certain other banks; 12 U.S.C. § 1463(g) (2009) is a "most favored lender" statute applicable to insured savings and loan associations; 12 U.S.C. § 1785(g) (2009) creates a "most favored lender" status for credit unions whose accounts are insured by the National Credit Union Administration Board. All of these federal statutes, among others, provide for an alternative means of determining the Maximum Lawful Rate of interest on a loan. However, it is likely that, with one exception, the federal statutes will provide no higher interest ceiling than is already available under Texas law for a typical real estate secured loan. The typical exception, however, is for loans made by federally-insured or federally-regulated lenders secured by first liens on residential real property, in which case federal law preempts any state law limitation on the rate or amount

Mortgaged Property: The Land and all buildings, structures and other improvements now or hereafter located on the Land.[39]

Note:[40] That certain Promissory Note of even date herewith executed by Borrower and payable to the order of Lender in the principal face amount of the Loan, as such Promissory Note may hereafter be renewed, extended, supplemented, increased, amended or modified and in effect from time to time, and all other promissory notes given in substitution therefor or in modification, renewal, amendment, restatement, increase or extension thereof, in whole or in part.

Person: Any corporation, limited liability company, general partnership, limited partnership, limited liability partnership, firm, association, joint venture, trust and any other organization or legal entity, including any public or governmental body, agency or instrumentality, as well as any natural person.[41]

Tax Code: The U.S. Internal Revenue Code of 1986, as amended,[42] any and all U.S. Department of Treasury Regulations issued pursuant thereto in temporary or final form, and any and all federal, state, county, municipal and city rules and rulings, notices, requirements, statutes, regulations or other Laws governing or relating to taxes or taxation, and any and all successor Laws thereof.

Tribunal: Any and all applicable courts, boards, agencies, commissions, offices or authorities of any nature whatsoever for any governmental unit (federal, state, county, district, municipal, city or otherwise), whether now or hereafter in existence.

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of interest, discount points, finance charges or other charges which may be charged, taken, received or reserved in connection with such loans. *See* 12 U.S.C. § 1735f-7a (2009). The effect of this federal preemption is that there is no usury ceiling for appropriately qualified lenders and loans. *See* annotations to definition of Default Interest Rate, in Section 1.1, *supra*, regarding limitations on interest. *See* TEX. FIN. CODE § 303 (West 2010). *See also* Michael R. Boulden and Sanford A. Weiner, Usury Update, 33rd Annual WILLIAM W. GIBSON, JR. MORTGAGE LENDING INSTITUTE (1999). *See* annotations to Annotated Promissory Note, Section 4.3 (Interest Provisions), for a more thorough discussion of the term "Maximum Lawful Rate" and an analysis of the usury savings provisions applicable to a promissory note. *See also* annotation to definition of "Default Interest Rate" in this Section 1.1 (Definitions), *supra*, annotation to clause (D) of Section 3.1(a)(xv) (Certain Agreements and Additional Waivers by Guarantor), *infra*, annotation to Section 6.6 (Attorneys' Fees and Costs and Collection), *infra*, and annotation to Section 6.17 (Controlling Agreement), *infra*, for discussions relating to usury in a Guaranty context.

[39] Any type of property which may be sold or conveyed, or which may pass by descent, may be mortgaged to secure an obligation. *See* Bellah v. First Nat'l Bank of Hereford, 478 S.W.2d 636, 638 (Tex. Civ. App.–Amarillo 1972, writ ref'd n.r.e.). *See also* annotations relating to the definition of "Mortgaged Property" in the Annotated Deed of Trust , Section 1.1 (Definitions).

[40] *See generally*, Nolan and Peterson, *supra* note 13.

[41] This definition of "Person" is broad and casts a wide net to include any natural living person or any entity. This eliminates the need throughout this Guaranty to state "any person or entity" since the definition of "Person" covers all potential business entities as well as individuals.

[42] 26 U.S.C. § 1 *et seq*. (2009).

1.2 Interpretation. Any capitalized term used and not defined in this Guaranty shall have the meaning given to such term in the **[Loan Agreement] [Deed of Trust].** All terms used herein, whether or not defined in this Article I, and whether used in singular or plural form, shall be deemed to refer to the object of such term whether such is singular or plural in nature, as the context may suggest or require. All pronouns, whether in the masculine, feminine or neuter form, shall be deemed to refer to the object of such pronoun whether same is masculine, feminine or neuter in gender, as the context may suggest or require. The terms "herein", "hereof", "hereto", "hereunder" and similar terms mean of, by, to, under or with respect to, this Guaranty. The terms "include" and "including" shall be interpreted as if followed by the words "without limitation".[43]

ARTICLE II
NATURE AND SCOPE OF GUARANTY

2.1 Guaranty of Payment. Guarantor hereby absolutely, unconditionally[44] and irrevocably[45] guarantees to Lender the punctual payment when due, whether on the scheduled

[43] In interpreting contracts, courts apply the rule of construction of *expressio unius est exclusio alterius*, which means that the expression of one or more things in a class implies the exclusion of all other items not expressed. *See* Allied Chem. Corp. v. Am. Indep. Oil Co., 623 S.W.2d 760, 763 (Tex. App.–Houston [1st Dist.] 1981, writ ref'd n.r.e.). Therefore, the phrase "without limitation" is often placed after the term "include" or "including" and before a list of items or provisions in order to overcome the implication of that rule of construction. Two legal concepts, however, must be addressed in determining whether the phrase "without limitation" is necessary: (i) the expansive view given to the words "include" and "including" by Texas courts, and (ii) the intention of the parties to a contract.

The Court of Appeals for the Fifth Circuit stated that the phrase "without limitation" is redundant because the word "including" is given an expansive view by Texas courts. *See* St. Paul Mercury Ins. Co. v. Lexington Ins. Co., 78 F.3d 202, 206-07 (5th Cir. 1996). *See also* Maley v. 7111 Sw. Freeway, Inc., 843 S.W.2d 229, 231 (Tex. App.–Houston [14th Dist.] 1992, writ denied) (referring to words such as "including" as words that "open the door" for courts to expand a list); El Paso Elec. Co. v. Safeway Stores, 257 S.W.2d 502, 506 (Tex. Civ. App.–El Paso 1953, writ ref'd n.r.e.) (noting that the words "including" and "includes" are generally accepted as terms of enlargement and not of limitation).

The overriding factor used by Texas courts in assessing whether the rule of construction of *expressio unius est exclusio alterius* should be applied is the intention of the parties to the contract. *See* Allied v. American, 623 S.W.2d at 763 (holding that "a rule of construction in law does not overrule or supersede the intention of the parties to the contract"); Jochec v. Clayburne, 863 S.W.2d 516, 520 (Tex. App.–Austin 1993, writ denied) (noting that "general rules of construction [are] necessarily arbitrary and should be used only as a 'tie-breaker' where more direct evidence does not resolve the ambiguity").

[44] The language of the guaranty determines its nature and scope. **Absolute, Unconditional Guaranty**: A guaranty can be unconditional, also known as an absolute guaranty, in which case the guarantor's obligation to pay the guaranteed indebtedness when it becomes due does not require the satisfaction of any other condition and is immediately enforceable. *See* Ford v. Darwin, 767 S.W.2d 851, 854 (Tex. App.–Dallas 1989, writ denied). If the guaranty is an absolute or unconditional guaranty, the guarantor's obligation to pay the guaranteed indebtedness can be enforced upon a default by the borrower without satisfaction of any other conditions, including any requirement that the lender take action against the borrower. *See* Joseph Thomas, Inc. v. Graham, 842 S.W.2d 343, 345 n.2 (Tex. App.–Tyler 1992, no writ). *See also* Bishop v. Nat'l Loan Investors, L.P., 915 S.W.2d 241 (Tex. App.–Fort Worth 1995, writ denied) (unconditional guarantor of note waives any requirements that holder take action against maker as condition precedent to guarantor's liability unless guaranty expresses states otherwise). **Conditional Guaranty**: Under a conditional guaranty, satisfaction of the conditions set forth in the guaranty (or established by law in the

payment date, by lapse of time, by acceleration of maturity, or otherwise, of all of the Guaranteed Indebtedness. This Guaranty covers the Guaranteed Indebtedness, whether presently outstanding or arising subsequent to the date hereof, including all amounts advanced by Lender in stages or installments. The guaranty of Guarantor as set forth in this Section 2.1 is a continuing[46] guaranty of payment and not a guaranty of collection.[47] Guarantor acknowledges

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case of a guaranty of collection [*see* fourth annotation to this Section 2.1 (Guaranty of Payment), *infra*]) must be satisfied prior to the guarantor's obligations becoming enforceable. For example, a guaranty can be conditioned upon foreclosure of the collateral, exhaustion of collection remedies against the borrower or the occurrence of some other act or event. Most lenders will require an absolute, unconditional guaranty, and this Guaranty has been drafted accordingly.

[45] As a general rule, a guaranty is revocable by the guarantor unless precluded by language in the guaranty. *See* Straus-Frank Co. v. Hughes, 156 S.W.2d 519, 520 (Tex. 1941); First Bank of Houston v. Bradley, 702 S.W.2d 683, 685 (Tex. App.–Houston [14th Dist.] 1985, no writ). If revoked, the guarantor is liable only for extensions of credit made prior to the revocation. *See* First Bank of Houston, 702 S.W.2d at 685-86. Even if a continuing guaranty is revocable, a revocation is only effective as to new debts created after the revocation. *See* Dicker v. Lomas & Nettleton Fin. Corp., 576 S.W.2d 672, 676 (Tex. Civ. App.–Texarkana 1978, writ ref'd n.r.e.). *See* third annotation to this Section 2.1 (Guaranty of Payment), *infra*, for a general discussion of a continuing guaranty.

[46] "A continuing guaranty is one which contemplates a future course of dealing between the [l]ender and [d]ebtor, and is intended to apply to other liabilities as they accrue." Vaughn v. DAP Fin. Servs., Inc., 982 S.W.2d 1, 5 (Tex. App.—Houston [1st Dist.] 1997, no writ). "A 'continuing guaranty' is a [g]uaranty which contemplates a series of future transactions and remains in effect, according to its terms, until revoked." Hercules Exploration, Inc. v. Halliburton Co., 658 S.W.2d 716, 724 (Tex. App.–Corpus Christi 1983, writ ref'd n.r.e.). *See also* second annotation to this Section 2.1 (Guaranty of Payment), *supra*, discussing the effect of revocation of a continuing guaranty. A guarantor under a continuing guaranty is not relieved of liability on the guaranteed indebtedness when the underlying promissory note is renewed, modified or extended. *See* Brazosport Bank of Tex. v. Travis, 617 S.W.2d 729, 731 (Tex. Civ. App.—Houston [14th Dist.] 1981, writ ref'd n.r.e.). In fact, a guarantor under a continuing guaranty is not relieved from liability even if the note is renewed or extended without the guarantor's knowledge. *See* Adcock v. First City Bank of Alice, 802 S.W.2d 305 (Tex. App.—San Antonio 1990, no writ).

In Vaughn, Vaughn signed an open continuing guaranty individually agreeing to repay all future loans made by Texas American Bank to his company, Gierhart/Vaughn Construction Company. Vaughn, 982 S.W.2d at 1. Gierhart (not Vaughn) later, in his capacity as president of the construction company, signed a promissory note with Texas American Bank. *See id.* The Appellate Court ruled that Vaughn was liable as to the future indebtedness (the promissory note) regardless of whether Vaughn signed the note because Vaughn had consented to the indebtedness by the terms of the guaranty. *See id.* Consent to any alteration of the underlying indebtedness is determined on a case-by-case basis according to the particular language of the guaranty, and courts have held guarantors to the terms of their consent as stated in their guaranties. For example, in Sonne v. F.D.I.C., 881 S.W.2d 789 (Tex. App.–Houston [14th Dist.] 1994, writ denied), the court held that the guarantor, by the terms of its guaranty, consented to a future increase of the original underlying indebtedness, even when such increase was agreed upon between the borrower and the lender without the guarantor's knowledge. *See id.* at 792. *See also* annotation to Section 3.1(a)(viii) (Certain Agreements and Additional Waivers by Guarantor), *infra*, discussing a guarantor's defense of material alteration and waiver of such defense.

[47] A guaranty can be a payment guaranty or a collection guaranty, but not both. Under a payment guaranty, the guarantor is liable as a primary obligor and the guaranty can be enforced by the lender against the guarantor without the lender having to proceed or take action against the borrower as a condition precedent to the guarantor's liability on the guaranty. *See* Hopkins v. First Nat'l Bank at Brownsville, 551 S.W.2d 343, 345 (Tex. 1977); Ferguson v. McCarrell, 582 S.W.2d 539 (Tex. Civ. App.–Austin 1979, writ ref'd n.r.e.). A payment guaranty is presumed to be an absolute, unconditional guaranty with regard to the guarantor's obligation to pay the debt unless there is language in the guaranty expressly establishing a condition. *See* J.I. Case Co. v. Laubhan, 77 S.W.2d 578,

and agrees that Guarantor may be required to pay the Guaranteed Indebtedness in full without assistance or support from Borrower or any other Person.[48] Guarantor agrees that if all or any

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579 (Tex. Civ. App.–Amarillo 1934, no writ). *See also* first annotation to this Section 2.1 (Guaranty of Payment), *supra*, discussing the effect of an absolute, unconditional guaranty. A payment guaranty, therefore, is presumed to be unqualified and to contain no other condition to enforceability except the default in performance by the principal obligor. *See* Austin v. Guar. State Bank, 300 S.W. 129 (Tex. Civ. App.–Waco 1927, no writ). Similarly, an absolute guaranty is presumed to be a guaranty of payment as opposed to a guaranty of collection unless the language in the guaranty provides to the contrary. *See id.*; *see also* Universal Metals & Mach., Inc. v. Bohart, 539 S.W.2d 874 (Tex. 1976).

Conversely, under a collection guaranty, the guarantor undertakes to pay the borrower's debt only if the debt cannot be collected from the borrower by the use of reasonable diligence. *See* Ford v. Darwin, 767 S.W.2d 854; Cox v. Lerman, 949 S.W.2d 527 (Tex. App.–Houston [14th Dist.] 1997, no writ). However, the authors have found no clear authority establishing what actions by a lender constitute "reasonable diligence" in attempting to collect payment from a borrower.

In Cox, the court considered the issue of what constitutes "reasonable diligence" to collect on a debt and found no case law authority in Texas establishing any specific criteria. *See* Cox, 949 S.W.2d at 531. Alternatively, the court looked to Rule 31 of the Texas Rules of Civil Procedure and Section 17.001 of the Texas Civil Practice and Remedies Code for guidance. The court determined that the requirements in these statutes providing that a guarantor who is not primarily liable may not be sued without joining the principal obligor set forth a minimum "standard of reasonableness with regard to the diligence required in collecting a debt from a primary obligor pursuant to a guaranty of collection." *Id*. In essence, the court concluded that a lender must, at a minimum, file suit against the principal obligor. A collection guaranty, therefore, is necessarily conditional, being conditioned upon both (i) the debtor's inability to pay, and (ii) the lender's inability to collect the debt by use of reasonable diligence against the debtor, and, according to the foregoing analysis, the guarantor can require that the lender file suit against the borrower or join the borrower as a party in an action by the lender to enforce the debt. *See also* last annotation to Section 2.3(a) (Primary Liability of Guarantor), *infra*.

Note, however, that Section 17.001 of the Texas Civil Practice and Remedies Code provides that a guarantor may be sued without first suing the principal obligor if the principal obligor: (1) is a nonresident or resides in a place where he cannot be reached by the ordinary process of law; (2) resides in a place that is unknown and cannot be ascertained by the use of reasonable diligence; (3) is dead; or (4) is actually or notoriously insolvent. *See* TEX. CIV. PRAC. & REM. CODE § 17.001 (West 2010). Furthermore, by analogy to Section 3.419(d) of the Texas Uniform Commercial Code (which governs accommodation parties executing a note accompanied by words indicating unambiguously that they are guaranteeing collection rather than payment), a lender may be entitled to seek payment from a guarantor under a collection guaranty without first suing the borrower if (i) the borrower is insolvent or subject to an insolvency proceeding, (ii) the borrower cannot be served with process, or (iii) "it is otherwise apparent" that the lender will be unable to collect from the borrower. *See* TEX. BUS. & COM. CODE ANN. § 3.419(d) (West 2010). A court thus may allow a lender to collect payment from a guarantor under a collection guaranty without first bringing suit against the principal obligor if the factual circumstances of the case mirror one of the foregoing exceptions. *See also* last annotation to Section 2.3(a) (Primary Liability of Guarantor), *infra*.

Because the rights of a lender to pursue a guarantor under a payment guaranty are unconditional and more clearly defined under Texas law, the lender's counsel, in drafting the guaranty, should clearly identify the guarantor as a guarantor of payment rather than a guarantor of collection so as to avoid any ambiguity that could be interpreted against the drafter and prevent prompt collection under the guaranty. Accordingly, this Guaranty clearly states that "the guaranty of Guarantor as set forth in this Section 2.1 is a continuing *guaranty of payment and not a guaranty of collection*." (emphasis added)

[48] Where a guarantor has signed a guaranty of payment or an absolute guaranty (as in this Guaranty), the guarantor is a primary obligor for the debt, and the lender need not pursue remedies against the borrower or any

part of the Guaranteed Indebtedness shall not be punctually paid when due, whether on the scheduled payment date, by lapse of time, by acceleration of maturity or otherwise, Guarantor shall, immediately **[upon demand by Lender] [(provided, however, that the failure of Lender to make such demand shall neither relieve nor discharge Guarantor in any respect of its obligations under this Guaranty, any condition or requirement of such demand to Guarantor's liability under this Guaranty being hereby waived by Guarantor)]**, pay the amount due on the Guaranteed Indebtedness to Lender at Lender's address as set forth herein. Lender may, but shall have no obligation to, make **[such]** demand(s) at any time coincident with or after the time for payment of all or part of the Guaranteed Indebtedness, and **[such]** demand(s) may be made from time to time with respect to the same or different items of the Guaranteed Indebtedness. **[Such demand shall be made, given and received in accordance with the notice provisions hereof.] [; provided, however, the failure to make, give or receive demand in accordance with the notice provisions hereof shall neither relieve nor discharge Guarantor in any respect of its obligations under this Guaranty, any condition or requirement of such demand to Guarantor's liability under this Guaranty being hereby waived by Guarantor.]**[49] The obligations and liability of Guarantor under this Section 2.1 shall

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other party. *See* Knick v. Green, 545 S.W.2d 269 (Tex. Civ. App.–Waco 1976, writ ref'd n.r.e.). S*ee also* first and fourth annotations to this Section 2.1 (Guaranty of Payment), *supra*.

[49] Notice issues can arise with respect to both the borrower and the guarantor. Many times both the borrower and the guarantor will have waived any notice requirement. In those cases, such a waiver is enforceable. *See, e.g.*, Shumway v. Horizon Credit Corp., 801 S.W.2d 890, 893 (Tex. 1991) (waiver of presentment, notice of intent to accelerate and notice of acceleration effective if clear and unequivocal); Star Food Processing, Inc. v. Killian, 954 S.W.2d 124, 126 (Tex. App.–San Antonio 1997, pet. denied) (parties may contractually waive notices regarding acceleration). Furthermore, if a borrower has waived notice, then this waiver is also effective as to the guarantor unless the guaranty contains notice requirements. *See* Mid-States Gen. Agency, Inc. v. Bank of Tex., 450 S.W.2d 428 (Tex. Civ. App.–Houston [1st Dist.] 1970, writ ref'd n.r.e.). If the guaranty contains any notice provisions, then the lender should comply with those notice provisions as to the guarantor. On the other hand, if the guaranty does not contain notice requirements but rather includes a waiver of notice, then such waiver of notice is effective as to the guarantor even if the borrower is otherwise entitled to notice. As a practical matter, however, if the borrower is entitled to a notice and cure period before the lender can declare a default, then the guarantor will not be liable under the guaranty until such default occurs (*i.e.*, not until the borrower fails to cure the default within such notice and cure period).

Prior to pursuing any collection remedies, the practitioner should review the note, the guaranty and all related loan documents to determine the existence of any requirement for notice or demand. In many instances, the borrower will have effectively waived any notice of default, opportunity to cure, notice of intent to accelerate and notice of acceleration in the note. As noted above, such waivers are effective to waive any requirement of any such notices to the guarantor. Further, regardless of whether the borrower waives notice, the guarantor can independently waive any requirement that notice be provided to the guarantor as a prerequisite to pursuing collection of the debt. However, in some instances, notice to the borrower is required by the loan documents, not merely to afford the borrower an opportunity to cure prior to the lender's pursuit of remedies against the borrower, but as a prerequisite to establishing a default. Pursuant to the terms of some notes, a default does not arise until the expiration of some period of time following written notice to the borrower of an act, omission or event which will rise to the level of a default if not cured or eliminated prior to the expiration of the specified time following the written notice. In such a case, notwithstanding any waiver of notice by the guarantor, no remedies can be pursued against the guarantor until notice has been given to the borrower and the specified time following notice has expired such that there is a default by the borrower that triggers the guarantor's obligation. As a practical matter, in the absence of some emergency situation requiring immediate action, the practitioner should consider making demand upon the guarantor prior to pursuing collection remedies even if such a demand has been waived. The demand upon the guarantor may be the first notice to the guarantor of problems with the underlying obligations and, notwithstanding the level of the not be limited or restricted in any way by the existence of, or by any terms of, the guaranty of performance under Section 2.2 of this Guaranty.[50]

[See Rider 1 for Limitations of Guaranteed Indebtedness.]

2.2 Guaranty of Performance. Guarantor additionally hereby absolutely, unconditionally and irrevocably guarantees to Lender the full, complete and timely performance of all of the Guaranteed Obligations,[51] including, without limitation, that Borrower will duly and

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guarantor's awareness, could potentially result in payment without the lender having to undertake more severe collection efforts.

See also second annotation to Section 2.2 (Guaranty of Performance), *infra*, and first annotation to Section 2.5 (Waivers), *infra*, for further discussion of waiver of notices.

[50] The purpose of the last sentence in this Section 2.1 (Guaranty of Payment) is to make clear that any limitation on Guarantor's liability to perform the Guaranteed Obligations under Section 2.2 (Guaranty of Performance) is not intended in any way to limit Guarantor's liability for payment of the Guaranteed Indebtedness. For example, Lender may agree to limit the performance obligations of Guarantor to certain specific items with respect to completion of improvements in a construction loan, without any intent to affect Guarantor's obligations to pay the Guaranteed Indebtedness. A similar provision is added at the end of Section 2.2 to the effect that any limitation on the amount of the Guaranteed Indebtedness (*see* Rider 1 [Limitations of Guaranteed Indebtedness], *infra*) shall in no way affect the obligation of Guarantor to perform the other Guaranteed Obligations.

[51] The general principle under Texas law is that the obligations and liability of a guarantor come directly from the liability of the borrower. *See* Gubitosi v. Buddy Schoellkopf Prods., Inc., 545 S.W.2d 528, 534 (Tex. Civ. App.–Tyler 1976, no writ) (liability of guarantor created by a guaranty agreement is measured by the liability of the principal, "unless a more limited or more extensive liability is specified by the guarantor"); Lawyers Sur. Corp. v. Texas, 825 S.W.2d 802, 803 (Tex. App.–Austin 1992, no writ) ("it is well settled that the surety is bound by the obligation of the principal, and 'such liability depends on the principal's liability'" [quoting Wright Way Constr. Co. v. Harlingen Mall Co., 799 S.W.2d 415, 426 (Tex. App.–Corpus Christi 1990, writ denied)]). If the obligations of a borrower have been discharged by performance "with its terms or other satisfaction by the principal obligor," a guarantor also becomes discharged from its obligations under the secondary obligation to the principal obligor. RESTATEMENT (THIRD) OF SURETYSHIP AND GUARANTY §19(a) (1996).

Unlike the obligations and liability of a guarantor for payment, common law recognizes a different standard for a guaranty of performance. If the borrower tenders complete or partial performance of its obligation and the lender unreasonably refuses such tender, then the guarantor is discharged to the extent that the performance tendered would have discharged the obligation of the guarantor. *See* RESTATEMENT (THIRD) OF SURETYSHIP AND GUARANTY §46 (1996). The standard is lower for a payment guaranty in that the lender simply has to refuse, not "unreasonably" refuse, such tender. The basis of this defense lies in the principle that the lender, by refusing a legitimate performance, has caused the guarantor to incur additional loss when the lender could have reasonably avoided it. This defense, like many others, can be waived so long as the lender can demonstrate that the guarantor "consented" to the waiver or release, either expressly or by certain actions. In this Guaranty, Guarantor has essentially waived this defense in Section 2.5 (Waivers), *infra*, by waiving the requirement that Lender sue or exhaust remedies against Borrower or other guarantors or obligors before pursuing the remedies available to Lender under the Guaranty. A guarantor can waive the right to have the lender pursue other remedies before pursuing the guarantor. Case law also suggests that a guarantor under an absolute, unconditional guaranty implicitly waives any requirement that the lender must take action against the borrower as a condition precedent to the guarantor's liability unless the guaranty expressly states otherwise. *See* Bishop v. Nat'l Loan Investors, L.P., 915 S.W.2d 241 (Tex. App.–Fort Worth 1995); Universal Metals & Mach., Inc. v. Bohart, 539 S.W.2d 874, 875 (Tex. 1976). *See also* first annotation to Section 2.1 (Guaranty of Payment), *supra*, and annotations to Section 2.5 (Waivers), *infra*.

punctually perform, observe and comply with all of the terms, covenants and conditions of the Note, the Deed of Trust and the other Loan Documents, whether according to the present terms thereof, at any earlier or accelerated date or dates as provided therein, or pursuant to any extension of time or to any change or changes in the terms, covenants or conditions thereof now or hereafter made or granted. If any of the Guaranteed Obligations are not complied with or performed, in any respect whatsoever, **[and without the necessity of any notice from Lender to Guarantor,]**[52] Guarantor agrees to (i) assume all responsibility for the full, complete and timely performance of the Guaranteed Obligations and, at Guarantor's own cost and expense, to perform and cause performance of all the Guaranteed Obligations in strict accordance with the Loan Documents, and (ii) ***INDEMNIFY, DEFEND AND HOLD LENDER HARMLESS FROM AND AGAINST ANY AND ALL LOSS, COST, LIABILITY OR EXPENSE THAT LENDER MAY SUFFER BY ANY REASON OF ANY SUCH NONCOMPLIANCE OR NONPERFORMANCE***.[53] The amount of any and all expenditures made by Lender resulting or

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Our research has not found any cases specifically addressing the enforceability of a performance (rather than a payment) guaranty in a loan context. *See also* second annotation to Rider 2 (Additional Construction Loan Performance Obligations), *infra*, discussing how there is an almost complete lack of legal precedent in relation to completion guaranties in construction loans. Other than for the specific obligation of loan repayment, there appears no legal precedent in Texas concerning the ability of a lender to seek specific performance of a guarantor's obligations beyond repayment of the loan itself. However, in lease guaranty situations, Texas courts have held lease guarantors liable for underlying lease obligations other than just the payment of rent. For example, in Clark v. Whitehead, 874 S.W.2d 282 (Tex. App.–Houston [1st Dist.] 1994, writ denied), Clark guaranteed the full performance of a lessee under a written lease agreement. The guaranty included, in addition to payment of rent, payment of property taxes, insurance premiums and other obligations under the lease. The court found Clark liable for the payment of property taxes that the lessee failed to pay in accordance with the terms of his guaranty. *See id*. at 284. Similarly, a court construing a performance guaranty under a loan likely will look to the terms of the guaranty in determining whether the guarantor should be liable for the obligations it agrees to fulfill.

See also annotations to Rider 2 (Additional Construction Loan Performance Obligations), *infra*, regarding performance guaranties in a construction loan context, including the annotation to Section 2.2 (Guaranty of Performance) therein.

[52] Note that in the surety context, notice of default to the surety is a condition precedent to the surety carrying out its obligations under a bond. In L & A Contracting Co. v. S. Concrete Servs., Inc., 17 F.3d 106 (5th Cir. 1994), the Fifth Circuit reversed a judgment against the surety on a subcontractor's performance bond when it found that letters sent by the obligee to the subcontractor and the surety failed, as a matter of law, to establish a declaration of default. The Fifth Circuit outlined the legal significance of giving notice of a declaration of default to the surety. It noted that "serious legal consequences attend a 'declaration of default,'" particularly in cases involving multi-million dollar construction projects. This case underscores the importance of giving notice. In some contexts, the surety is not obligated to act unless notice is given pursuant to the terms of the bond. The requirement of notice, however, like other surety defenses, can be waived. *See* L & A Contracting, 17 F.3d at 111; Balfour Beatty Constr. v. Colonial Ornamental Iron Works, Inc., 986 F. Supp. 82 (D. Conn. 1997). *See also* sixth annotation to Section 2.1 (Guaranty of Payment), *supra*, and first annotation to Section 2.5 (Waivers), *infra*. *But see* Colo. Structures, Inc. v. Ins. Co. of the W., 161 Wash.2d 577, 167 P.3d 1125 (Wash. Sep 20, 2007) (declining to follow the Fifth Circuit's holding in L & A and holding that a surety's liability was not conditioned on the contractor's having declared a subcontractor to be in default when the contractor permitted the subcontractor to continue work under the contract and then sued for damages when the subcontractor's performance was complete).

[53] Indemnities included in a guaranty are often the subject of considerable negotiation. This Guaranty endeavors to provide both the maximum protection to Lender and the appropriate notice to Guarantor of the existence of indemnity obligations contained therein by printing all indemnities in bold, capital letters. As noted by the Texas Supreme Court in Dresser Indus., Inc. v. Page Petroleum, Inc., 853 S.W.2d 505 (Tex. 1993), citing Black's

arising from Guarantor's failure to perform the Guaranteed Obligations pursuant to the terms hereof shall be immediately due and payable by Guarantor to Lender **[upon demand] [(provided, however, that the failure of Lender to make such demand shall neither relieve**

Law Dictionary, 692 (5th Ed. 1979), an indemnity agreement is defined as "a collateral contract or assurance by which one person engages to secure another against an anticipated loss or to prevent him from being damnified by the legal consequences of an act of forbearance on the part of one of the parties or some third person." An indemnity agreement is a promise to safeguard or hold the indemnitee harmless against either existing or future loss or liability. The agreement creates a potential cause of action against the indemnitor. *See* Dresser, 853 S.W.2d at 508. As such, all indemnity provisions operate to transfer risk, and in light of the Express Negligence Doctrine discussed below in this annotation, it seems only prudent and fair that such provisions be conspicuous and provide fair notice to the indemnitor regardless of whether the Express Negligence Doctrine is applicable to the particular indemnitor. *See generally* K&S Oil Well Serv. Inc. v. Cabot Corp., 491 S.W.2d 733 (Tex. Civ. App.–Corpus Christi 1973, writ ref'd n.r.e.). Although a majority of the current case law addresses the Express Negligence Doctrine wherein the indemnitor is indemnifying the indemnitee against its own negligence, it is our conclusion that as a matter of both caution for Lender and fair notice concerns to Guarantor, that any indemnity provision be drafted as if the concepts expressed in Dresser and Enserch Corp. v. Parker, 794 S.W.2d 2 (Tex. 1990), were applicable.

The Texas Supreme Court has held that, in addition to the traditional indemnification concepts, a party may contract in advance to protect itself against its own negligence by means of an indemnification agreement, provided that certain fair notice requirements are met that are designed to assure that the party to whom the risk is shifted understands the meaning and effect of the agreement. *See* Enserch, 794 S.W.2d at 8, Am. Indem. Lloyds v. Travelers Prop. & Cas. Ins. Co., 335 F.3d 429, 435 (5th Cir. Tex. 2003). Because an agreement under which a party agrees to assume liability for another party's negligence may involve an extraordinary shifting of risk, the courts will look very carefully to determine if these fair notice requirements have been met. *See* U.S. Rentals, Inc. v. Mundy Serv. Corp., 901 S.W.2d 789, 791 (Tex. App.–Houston [14th Dist.] 1995, writ denied), Enron Corp. Savings Plan v. Hewitt Associates, L.L.C., 611 F.Supp.2d 654) (S.D. Texas 2010). Subsequent to the Enserch decision, the Texas Supreme Court has further clarified the fair notice requirements pronouncing that an indemnification agreement must meet a two-part test in order to relieve a party of its own negligent conduct. *See* Dresser, 853 S.W.2d at 509. First, the party seeking the indemnity for the consequence of its own negligence must express the intent in specific terms within the four corners of the document. This concept is referred to as the "Express Negligence Doctrine." *See* Ethyl Corp. v. Daniel Constr. Co., 725 S.W.2d 705 (Tex. 1987). Second, the indemnification provisions must be conspicuous enough to give the party to whom risk is shifted fair notice of its existence. *See* Dresser, 853 S.W.2d at 509. Compliance with each of these fair notice requirements is a question of law for the court to decide. *See id.* at 510. - 511. By adopting the Express Negligence Doctrine, the Texas Supreme Court intended to "require scriveners to make it clear when the intent of the parties is to exculpate an indemnitee for the indemnitee's own negligence." Atl. Richfield Co. v. Petroleum Pers., Inc., 768 S.W.2d 724, 726 (Tex. 1989). Practitioners should also focus upon and pay strict attention to the second part of the test – that the clause indemnifying against negligence must be "conspicuous" under the objective standard defined in the Texas Business and Commerce Code. *See* Littlefield v. Schaefer, 955 S.W.2d 272 (Tex. 1997). The definition of "conspicuous" contained in the Texas Business and Commerce Code provides that the clause must be written so that "a reasonable person against whom it is to operate ought to have noticed it." TEX. BUS. & COM. CODE ANN. § 1.201(10) (West 2010). Texas adopts the "conspicuous" standard as provided in the Texas Business and Commerce Code. *See* Dresser, 853 S.W.2d at 511. The Texas Business and Commerce Code gives additional guidance on what is considered conspicuous providing that terms such as printed headings and capitals, larger type and contrasting colors will generally meet the standard. Note that in Littlefield, the Texas Supreme Court held that the fact that the heading for a particular provision which had larger font size than the clause's language did not, in and of itself, make the clause conspicuous. The court in Littlefield further held that the Code definition of conspicuous requires that "language in a body of a form must be in larger or other contrasting type or color." Comment 10 of Section 1.201(10) of the Texas Business and Commerce Code further clarifies the inquiry. The test is whether attention can reasonably be expected to be drawn to the provision. It is for this reason that in this Guaranty all indemnities are in bold print. As a further measure of caution, although not necessarily required by the existing cases, it may be prudent to have in a document that contains indemnifications a further "stand-alone" indemnification notice on the signature page.

nor discharge Guarantor in any respect of its obligations under this Guaranty, any condition or requirement of such demand to Guarantor's liability under this Guaranty being hereby waived by Guarantor)],[54] together with interest at the Default Interest Rate. Guarantor further acknowledges and agrees that Guarantor may be required to perform the Guaranteed Obligations in full without assistance or support from Borrower or any other Person. Guarantor agrees that if all or any part of the Guaranteed Obligations shall not be punctually performed when and as stated in the Loan Documents, Guarantor shall, immediately **[upon demand by Lender] [(provided, however, that the failure of Lender to make such demand shall neither relieve nor discharge Guarantor in any respect of its obligations under this Guaranty, any condition or requirement of such demand to Guarantor's liability under this Guaranty being hereby waived by Guarantor)]**, perform the Guaranteed Obligations. Lender may, but shall have no obligation to, make **[such]** demand(s) at any time coincident with or after the time for performance of all or part of the Guaranteed Obligations, and **[such]** demand(s) may be made from time to time with respect to the same or different items of the Guaranteed Obligations. **[Such demand shall be made, given and received in accordance with the notice provisions hereof.] [; provided, however, the failure to make, give or receive demand in accordance with the notice provisions hereof shall neither relieve nor discharge Guarantor in any respect of its obligations under this Guaranty, any condition or requirement of such demand to Guarantor's liability under this Guaranty being hereby waived by Guarantor.]** The obligations and liability of Guarantor under this Section 2.2 shall not be limited or restricted in any way by the existence of, or by any terms of, the guaranty of payment under Section 2.1 of this Guaranty.

[*See Rider 2 for Additional Construction Loan Performance Obligations.*]

2.3 Primary Liability of Guarantor.

(a) This Guaranty is an absolute, unconditional and irrevocable guaranty of payment and performance.[55] Each Guarantor (if more than one) is and shall be jointly and severally liable for the payment and performance of the Guaranteed Obligations, as set forth in this Guaranty, as a primary obligor.[56] This Guaranty shall be effective as a waiver of, and Guarantor hereby expressly waives, any and all rights to which Guarantor may otherwise have been entitled under any suretyship laws or similar Laws in effect from time to time, including any right or privilege, whether existing under statute, at law or in equity, to require Lender to take prior recourse or proceedings against any collateral, security or Person whatsoever. This waiver by Guarantor is intended to waive, and

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[54] *See* sixth annotation to Section 2.1 (Guaranty of Payment), *supra*, second annotation to this Section 2.2 (Guaranty of Performance), *supra*, and first annotation to Section 2.5 (Waivers), *infra*, for a discussion of waiver of notices.

[55] *See* annotations to Section 2.1 (Guaranty of Payment), *supra*, and first annotation to Section 2.2 (Guaranty of Performance), *supra*.

[56] *See* annotations to Section 2.1 (Guaranty of Payment), *supra*. *See also* annotations to Section 6.3 (Binding Effect), *infra*.

Guarantor hereby expressly waives, any and all rights pursuant to Rule 31 of the Texas Rules of Civil Procedure, Section 17.001 of the Texas Civil Practice and Remedies Code, Chapter 43 of the Texas Civil Practice and Remedies Code, and any and all amendments, recodifications or supplements to any such Laws.[57]

(b) In the event of any Default, the Guaranteed Obligations, for purposes of this Guaranty, shall be deemed immediately due and payable, and Guarantor shall, **[on demand] [(provided, however, that the failure of Lender to make such demand shall neither relieve nor discharge Guarantor in any respect of its obligations under this Guaranty, any condition or requirement of such demand to Guarantor's liability under this Guaranty being hereby waived by Guarantor)] [, and]** without presentment, protest, notice of protest, notice of nonpayment or of dishonor or of default or nonperformance, or notice of acceleration or intent to accelerate, or any other notice whatsoever, without any notice having been given to Guarantor of the acceptance by Lender of this Guaranty, and without any notice having been given to Guarantor of such obligation to pay and perform, all such notices being hereby waived by Guarantor (which waiver is in addition to, and not in limitation of, any and all waivers of Guarantor in

[57] Texas Rule of Civil Procedure 31 provides that a surety cannot be sued without its principal unless a judgment has been previously obtained against the principal. The surety's rights under this rule, however, can be waived. *See* Hernandez v. Bexar County Nat'l Bank of San Antonio, 710 S.W.2d 684, 689 (Tex. App.–Corpus Christi 1986), *writ ref'd n.r.e. per curiam*, 716 S.W.2d 938 (Tex. 1986) (waiver of rights under §17.001 and Rule 31 are valid and enforceable); Yandell v. Tarrant State Bank, 538 S.W.2d 684, 687 (Tex. Civ. App.–Fort Worth 1976, writ ref'd n.r.e.) (waiver of rights under §17.001 and Rule 31 are valid and enforceable). Chapter 17 of the Texas Civil Practice and Remedies Code prohibits entry of a judgment against a guarantor that is not primarily liable unless a judgment is also rendered against the borrower, unless certain exceptions apply. *See* TEX. CIV. PRAC. & REM. CODE §17.001 (West 2010). Chapter 17 allows the lender to sue a guarantor without suing the principal obligor if the principal obligor: (1) is a nonresident or resides where he cannot be reached by ordinary process of law; (2) resides in a place that is unknown and cannot be ascertained by using reasonable diligence; (3) is dead; or (4) is actually or notoriously insolvent. *See* TEX. CIV. PRAC. & REM. CODE §17.001(b) (West 2010). Consequently, a guarantor under a collection guaranty could not be sued without the borrower unless one of these exceptions applies. *See* Ford v. Darwin, 767 S.W.2d 851, 854 (Tex. App.–Dallas 1989, writ denied). *See also* fourth annotation to Section 2.1 (Guaranty of Payment), *supra*. Since a guarantor under a payment guaranty is primarily liable, however, there is no requirement that the borrower be sued along with the guarantor. *See id*. *See also* first and fourth annotations to Section 2.1 (Guaranty of Payment), *supra*. Further, the provisions in Section 17.001 can be waived. *See* Hernandez, 710 S.W.2d at 689; Yandell, 538 S.W.2d at 687. In Texas, guarantors and other sureties have the right to require the lender to exhaust its remedies against the borrower for payment of the loan before seeking enforcement of the guaranty. *See* TEX. CIV. PRAC. & REM. CODE § 43.001 *et seq*. (West 2010). Section 43.002 of the Texas Civil Practice and Remedies Code allows a guarantor to demand that the holder take timely action against the borrower and file suit on an accrued action, and if the holder fails to do so, the guarantor is relieved of its obligations and the guarantor's liability is extinguished. *See id*. Contractual waiver of these rights, however, has been held to be enforceable. *See* Hanks v. NCNB Tex. Nat'l Bank, 815 S.W.2d 763, 764, (Tex. App.– Eastland 1991, no writ). Further, this section of the Texas Civil Practice and Remedies Code does not apply to payment guaranties, because a payment guarantor essentially waives its rights to insist that the lender first seek payment from the borrower. *See id*. *See also* Ford v. Darwin, 767 S.W.2d at 855 ("guarantor of payment waives any requirement that the holder of the note take any action against the borrower as a condition precedent to his liability on the note"); s*ee also* first and fourth annotations to Section 2.1 (Guaranty of Payment), *supra*. Following the above analysis, Lender's counsel should be careful to include in the Guaranty a general waiver of all rights under applicable law that a surety may have, specifically including an express waiver of the rights under Texas Rule of Civil Procedure 31, Texas Civil Practice & Remedies Code §17.001, and the Texas Civil Practice and Remedies Code §43.01-05.

Section 2.5 below and elsewhere in this Guaranty),[58] promptly pay the Guaranteed Indebtedness to Lender **[without notice or demand, of any kind or nature,]** in lawful money of the United States of America, or perform the Guaranteed Obligations, as the case may be, and pay all damages and all costs and expenses that may arise in consequence of such Default (including, without limitation, all attorneys' fees and expenses, investigation costs, court costs, and any and all other costs and expenses incurred by Lender in connection with the collection and enforcement of the Note, this Guaranty or any other Loan Document), whether suit is filed thereon, or whether at maturity or by acceleration, or whether before or after maturity, or whether in connection with bankruptcy, insolvency or appeal.[59] It shall not be necessary for Lender, in order to

[58] *See* sixth annotation to Section 2.1 (Guaranty of Payment), *supra*, second annotation to Section 2.2 (Guaranty of Performance), *supra*, and first annotation to Section 2.5 (Waivers), *infra*, for a discussion of waiver of notices.

[59] There are a number of remedies available to a lender against a guarantor in the event of a default. **Suit to Enforce Guaranty**: The most common remedy for enforcing a guaranty is a suit against the guarantor to collect the outstanding portion of the guaranteed indebtedness plus pre-judgment interest and attorneys' fees. If the guaranty or the loan documents provide for the recovery of attorneys' fees, the lender is entitled to recover the attorneys' fees actually incurred. *See* RepublicBank Dallas, N.A. v. Shook, 653 S.W.2d 278, 282 (Tex. 1983). If the guaranty or other loan documents provide for the recovery of attorneys' fees equal to a specified percentage of the unpaid balance of the debt, the provision is not an absolute promise to pay the stated percentage, but has been held to be an agreement to indemnify the lender for the attorneys' fees actually incurred, and the fees awarded pursuant to the provision will be limited to a reasonable amount if the percentage amount is challenged by the obligor. *See id*.; *See also* Richardson v. Office Bldgs. of Houston, 704 S.W.2d 373, 376 (Tex. App.—Houston [14th Dist.] 1985, no writ). However, attorneys' fees are recoverable from a guarantor even if its guaranty does not expressly provide for the recovery of attorneys' fees. *See* Lyons v. Montgomery, 701 S.W.2d 641, 644 (Tex. 1985). A guaranty is a contract, and Section 38.001(8) of the Texas Civil Practice and Remedies Code provides for the recovery of reasonable attorneys' fees in addition to the amount of the valid claim and costs if the claim is for "an oral or written contract." TEX. CIV. PRAC. & REM. CODE ANN. § 38.001(8) (West 2010). However, in order to recover attorneys' fees under Section 38.001(8) of the Texas Civil Practice and Remedies Code, the claimant must be represented by an attorney, must present the claim to the opposing party or duly authorized agent of the opposing party, and payment for the just amount owed must not have been tendered before the expiration of the 30th day after the claim was presented. *See* TEX. CIV. PRAC. & REM. CODE § 38.002 (West 2010). *See also* annotation to Section 6.6 (Attorneys' Fees and Costs of Collection), *infra*.

Prior to the entry of judgment, a lender's remedies against a guarantor are limited. **Right of Setoff**: A lender may have a common law right or a contractual right of setoff. *See* annotation to Section 6.8 (Right of Setoff), *infra*. **Pre-Judgment Garnishment**: If the lender is aware of funds or property in the hands of a third party belonging to the guarantor, pre-judgment garnishment may be available. Garnishment is a judicial remedy available to creditors seeking assets of a debtor held by a third party, the garnishee. Sections 63.001 through 63.006 of the Texas Civil Practice and Remedies Code and Rule 657-679 of the Texas Rules of Civil Procedure set forth the specific circumstances in which a garnishment may be pursued. *See* TEX. CIV. PRAC. & REM. CODE ANN. §§ 63.001-63.006 (West 2010); TEX. R. CIV. P. 657-679 (West 2010). Pre-judgment garnishment is available only if the lender sues for the debt and makes an affidavit stating that the debt is just, due and unpaid, that within the lender's knowledge the guarantor does not possess property in Texas subject to execution sufficient to satisfy the debt, and that the garnishment is not sought to injure the guarantor or the garnishee. *See* TEX. CIV. PRAC. & REM. CODE ANN. § 63.001(2)(A)-(C) (West 2010). **Attachment**: Under certain circumstances, the pre-judgment remedy of attachment may be available. Attachment is a judicial remedy available to an unsecured creditor seeking to control assets of the debtor in order to prevent their secretion and disposition. Texas Civil Practice and Remedies Code Section 61.001 through Section 61.063, and Rules 592 through 609 of the Texas Rules of Civil Procedure, set forth the circumstances and requirements for attachment. *See* TEX. CIV. PRAC. & REM. CODE ANN. §§ 61.001-61.063 (West 2010); TEX. R. CIV. P. 592-609 (West 2010). Attachment is available to a plaintiff in a suit if (1) the enforce such payment or performance by Guarantor, first, or contemporaneously, to institute suit or pursue or exhaust any rights or remedies[60] against Borrower or any other Person liable on the Guaranteed Obligations or for such payment or performance, or to enforce any rights, remedies, powers, privileges or benefits of Lender against any security or collateral that shall ever have been given to secure[61] the Guaranteed

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defendant is justly indebted to the plaintiff; (2) the attachment is not sought for the purpose of injuring or harassing the defendant; and (3) the plaintiff will probably lose his debt unless the writ of attachment is issued. *See* TEX. CIV. PRAC. & REM. CODE ANN. § 61.001(1)-(3) (West 2010). In addition, attachment is only available if the defendant is a non-resident or foreign corporation; the defendant is about to move permanently from Texas and has refused to pay or secure the debt due to the plaintiff; the defendant is in hiding so that ordinary process cannot be served upon him; the defendant has hidden or is about to hide his property for the purpose of defrauding his creditors; the defendant is about to remove his property from Texas without leaving an amount sufficient to pay his debts; the defendant is about to remove all or part of his property from the county in which the suit has been brought with the intent to defraud his creditors; the defendant has disposed of or is about to dispose of all or a part of his property with the intent to defraud his creditors; the defendant is about to convert all or part of his property into cash for the purpose of placing it beyond the reach of his creditors; or the defendant owes the plaintiff for property obtained by the defendant under false pretenses. *See id.* § 61.002(1)-(9).

Following entry of a judgment against a guarantor, the lender will be entitled to pursue all rights and remedies available in Texas to judgment creditors including, but not limited to: (1) **abstracting the judgment** to create a lien against any and all real property of the guarantor in each county in which the abstract is recorded (*see* TEX. PROP. CODE ANN. §§ 52.001-52.025 (2006)); (2) **post judgment garnishment** (*see* TEX. CIV. PRAC. & REM. CODE ANN. § 63.001(3) (West 2010); TEX. R. CIV. P. 657-679 (West 2010)); (3) **execution** against non-exempt real or personal property of the guarantor (*see* TEX. CIV. PRAC. & REM. CODE ANN. §§ 34.001-34.076 (West 2010); TEX. R. CIV. P. 621-656 (West 2010)); or (4) obtaining a **turnover order** from the court if justified under the circumstances (*see* TEX. CIV. PRAC. & REM. CODE ANN. § 31.002 (West 2010)). *See also* Rider 7 (Exclusion of Certain Guarantor Assets), *infra*, for sample language to include in the Guaranty when Lender has agreed not to pursue its remedies against certain excluded assets of Guarantor.

See also annotations to definition of "Default" in Section 1.1 (Definitions), *supra*.

[60] Under a guaranty of collection, the guarantor has the right to insist that the lender pursue remedies against the borrower pursuant to Section 43.002 of the Texas Civil Practice and Remedies Code. Under a guaranty of payment, however, the guarantor does not have the right to insist that the lender pursue remedies against the borrower before turning to the guarantor for payment, since the guarantor is primarily liable. *See* Hanks, 815 S.W.2d at 764-65. *See also* first and fourth annotations to Section 2.1 (Guaranty of Payment), *supra*, and last annotation to Section 2.3(a) (Primary Liability of Guarantor), *supra*.

[61] Absent a showing of a peculiar hardship on the part of the guarantor, the lender is free to pursue collection of amounts due from the guarantor without first pursuing recovery by enforcing a security interest in collateral. *See* RESTATEMENT (THIRD) SURETYSHIP AND GUARANTY § 51 (1996); Boyd v. Diversified Fin. Sys., 1 S.W.3d 888, 894 (Tex. App.–Dallas 1999, no pet.). A holder of a secured note may sue a guarantor on the indebtedness without first resorting to the collateral. *See* Lazidis v. Goidl, 564 S.W.2d 453, 456 (Tex. Civ. App.–Dallas 1978, no writ). Note, however, that the Lazidis case does not specify what type of guaranty was involved. Consequently, a lender attempting to collect under a guaranty of collection may, depending on the facts of the case, have obligations to foreclose on collateral before turning to the guarantor for payment. *See also* fourth annotation to Section 2.1 (Guaranty of Payment), *supra*, and last annotation to Section 2.3(a) (Primary Liability of Guarantor), *supra*. Also, a guaranty could be made conditional upon the lender first exercising its rights in collateral before pursuing the guarantor. *See* first annotation to Section 2.1 (Guaranty of Payment), *supra*. In addition to the language in this Section 2.3(b), this Guaranty contains, in Section 2.5 (Waivers), *infra*, a waiver of any right Guarantor may have to force Lender to first proceed against collateral before pursuing Guarantor under the Guaranty, in an effort to prevent Guarantor from successfully asserting this as a defense to payment.

Obligations or the payment or performance thereof, or to join Borrower or any other Person liable for the payment or performance of the Guaranteed Obligations or any part thereof in any action to enforce this Guaranty, or to resort to any other means of obtaining payment or performance of the Guaranteed Obligations. Nothing contained herein, however, shall in any way prevent Lender from suing on the Note or foreclosing the lien of the Deed of Trust or from exercising any other rights or remedies thereunder or under any of the other Loan Documents,[62] and if such foreclosure or other remedy is availed of, only the proceeds therefrom, after deduction of all charges and expenses of every kind and nature whatsoever, shall be applied in reduction of the principal balance and accrued interest due under the Note. The application of any such net proceeds shall not reduce or diminish Guarantor's liability for any deficiency in the amount which remains unpaid on the Guaranteed Obligations after the application of such net proceeds. Furthermore, if either (A) the Guaranteed Indebtedness is less than all amounts due and owing by Borrower to Lender under the Loan, or (B) the Guarantor's liability for the Guaranteed Indebtedness is limited in Section 2.1 above, then such net proceeds shall be applied first to all indebtedness of Borrower to Lender other than the Guaranteed Indebtedness, and then to the Guaranteed Indebtedness, such that Guarantor remains liable for any such deficiency to the fullest extent of the Guaranteed Indebtedness.[63] Lender shall not be required to institute or prosecute proceedings to recover any such deficiency as a condition of payment hereunder or enforcement hereof. At any sale of the Mortgaged Property or any other collateral securing the Guaranteed Obligations or any part thereof, whether by foreclosure, exercise of power of sale, or otherwise, Lender may in its discretion purchase all or any part of the Mortgaged Property or collateral so sold or offered for sale for its own account and may, in payment of the amount bid therefor, deduct such amount from the Guaranteed Indebtedness.[64]

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[62] *See* annotation to Section 2.3(c) (Primary Liability of Guarantor), *infra*, and first annotation to Section 3.1(a)(ix) (Certain Agreements and Additional Waivers by Guarantor), *infra*.

[63] *See* first annotation to Rider 1 (Limitations of Guaranteed Indebtedness), *infra*.

[64] The mere fact that the lender was the successful bidder at a foreclosure sale does not, by itself, invalidate the liability of a guarantor for a deficiency realized at the foreclosure. *See* Resolution Trust Corp. v. Westridge Ct. Joint Venture, 815 S.W.2d 327 (Tex. App.–Houston [1st Dist.] 1991, writ denied). It is prudent practice, however, for a deed of trust and the guaranty to contain a provision expressly granting the lender the right to act as a purchaser at foreclosure and stating that the lender may bid for its own account and deduct such bid against the balance of the amounts owing to the lender. *See* Tarrant Sav. Ass'n v. Lucky Homes, Inc., 390 S.W.2d 473 (Tex. 1965); McClure v. Casa Claire Apartments, Ltd., 560 S.W.2d 457 (Tex. Civ. App.–Beaumont 1977, no writ); *see also* Annotated Deed of Trust, Section 7.1(j) (Beneficiary as Purchaser). The deed of trust should also indicate that the lender, as a purchaser at foreclosure, should be treated in the same manner as any third-party purchaser and that the proceeds of the lender's purchase will be applied in the manner indicated in the deed of trust or the other loan documents. This is an attempt to address the holdings in Lee v. Sabine Bank, 708 S.W.2d 582, 584 (Tex. App.–Beaumont 1986, writ ref'd n.r.e.) and Olney Sav. & Loan Ass'n v. Farmers Mkt. of Odessa, Inc., 764 S.W.2d 869 (Tex. App.–El Paso 1989, writ denied), which appear to require a lender when it is a purchaser at foreclosure to be treated differently than a third-party purchaser. The court in Olney, citing Sabine, stated that the lender was "under a trust arrangement with the borrower [and] it must, in the event of foreclosure, make an honest effort to reduce the loan as much as possible by securing a fair price for the collateral." Olney, 764 S.W.2d at 871. *But see* Pentad Joint Venture v. First Nat'l Bank of La Grange, 797 S.W.2d 92 (Tex. App.-Austin 1990, writ denied) (declining to recognize a trust

(c) Suit may be brought or demand may be made against Borrower or against all Persons who have signed this Guaranty or any other guaranty in favor of Lender covering all or any part of the Guaranteed Obligations, or against any one or more of them, separately or together, without impairing the rights of Lender against Guarantor or any such Person. Any time that Lender is entitled to exercise Lender's rights or remedies hereunder, Lender may in its discretion elect to demand payment or performance or both payment and performance.[65] If Lender elects to demand performance, it shall at all times thereafter have the right to demand payment until all of the Guaranteed Obligations have been paid and performed in full. If Lender elects to demand payment, it shall at all times thereafter have the right to demand performance until all of the Guaranteed Obligations have been paid and performed in full.

2.4 Other Liability of Guarantor or Borrower. If Guarantor is or becomes liable, by endorsement or otherwise, for any indebtedness owing by Borrower to Lender other than the Guaranteed Obligations, the liability of Guarantor for such other indebtedness shall not in any manner be impaired or affected hereby, and the rights of Lender hereunder shall be cumulative of any and all other rights that Lender may have against Guarantor. If Borrower is or becomes indebted to Lender for any indebtedness other than or in excess of the Guaranteed Indebtedness, any payment received or recovery realized upon any such other indebtedness of Borrower to Lender may be applied, in Lender's sole discretion, to indebtedness of Borrower to Lender other than the Guaranteed Indebtedness, except to the extent paid by Guarantor on the Guaranteed Indebtedness or specifically required by Law or written agreement of Lender to be applied to the Guaranteed Indebtedness.[66] This Guaranty is independent of, and shall not be limited by, any

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agreement and an affirmative duty on a mortgagee to procure the highest price possible for a mortgagor at a foreclosure sale). *See* TEX. PROP. CODE ANN. §§ 51.003 and 51.005 (West 2010); Annotated Deed of Trust, Section 7.4 (Application of Proceeds). S*ee also* last annotation to Section 2.5 (Waivers), *infra*, regarding the right of a guarantor to challenge the sale price of real property at foreclosure.

[65] Multiple consistent remedies can be pursued until a debtor's obligation to a creditor is actually satisfied. *See* In re Gayle, 189 B.R. 914, 916 (Bankr. S.D. Tex. 1995). In Gayle, the court rejected the debtors' argument that the election of remedies doctrine precluded the lender from foreclosing on a deed of trust since the lender had previously obtained a judgment against the debtors on the underlying note. Under the Gayle court's analysis, a lender would also be able to foreclose on a deed of trust while pursuing a judgment against a guarantor on a payment guaranty. *See also* first annotation to Section 3.1(a)(ix) (Certain Agreements and Additional Waivers by Guarantor), *infra*.

[66] Issues with respect to direction of payments may arise in situations where: (1) the borrower owes multiple debts to the lender, but only some of them are guaranteed by the guarantor; or (2) the borrower's debt to the lender exceeds the amount covered by the guaranty (*i.e.*, the guarantor has signed a guaranty which is capped or limited in amount and the indebtedness of the borrower to the lender exceeds the capped limit [*see, e.g.*, Rider 1 (Limitations of Guaranteed Indebtedness), *infra*, for examples of such limitations of liability]). As the following analysis indicates, the guarantor likely has the right to direct the application of payments made by the *guarantor*, as opposed to the application of payments made by a borrower.

Under Texas law, if the parties have agreed that a payment will be applied to a certain indebtedness or if the obligor has directed such application, then the agreement or direction is controlling. *See* Watson v. Cargill, Inc., Nutrena Div., 573 S.W.2d 35, 39 (Tex. Civ. App.–Waco 1978, writ ref'd n.r.e.). In the absence of directions from the obligor as to the application of payments, an agreement between the parties controls. *Id*. It is unclear whether the obligor can direct application of payments when the agreement provides otherwise. However, courts have held other guaranty now existing or hereafter given. Further, Guarantor's liability under this Guaranty is in addition to any and all other liability Guarantor may have in any other capacity, including, without limitation, its capacity as a general partner or managing member of Borrower.[67]

2.5 Waivers.[68] Guarantor hereby expressly waives: (i) any right to revoke this Guaranty with respect to the Guaranteed Obligations;[69] (ii) any right to require Lender to do any

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that the right to direct payments is "absolute," and it is clear that an agreement set forth in the loan documents can be waived by a subsequent agreement or by the conduct of the parties. *See* Copes v. Perkins, 6 Tex. 150, 151 (1851); Munday Trading Co. v. J.M. Radford Grocery Co., 190 S.W. 520, 521 (Tex. Civ. App.–Fort Worth 1916, no writ); Keasler v. Wray, 171 S.W. 534, 537 (Tex. Civ. App.–Texarkana 1914, no writ); H. Richards Oil Co. v. W. S. Luckie, Inc., 391 S.W.2d 135, 139 (Tex. Civ. App.–Austin 1965, writ ref'd n.r.e.) (obligor's right to direct the application of payments is absolute); Gourley v. Iverson Tool Co., 186 S.W.2d 726, 731 (Tex. Civ. App.–Fort Worth 1945, writ ref'd w.o.m) (when an obligor directs that a payment made by him be applied to any one or more of debts owed by him, the obligee has no option other than to apply the payments as directed or return them).

As a general rule, a guarantor has no right to require that payments made by the *borrower* be applied to the guaranteed portion of the debt. *See* 58 TEX. JUR. 3D *Payment* § 78, 92 - 93 (2007). However, the payment principles discussed above have been applied to payments tendered by a *guarantor* where the payments were made from the *guarantor's* funds. In Warrior Constructors v. Small Bus. Inv. Co. of Houston, 536 S.W.2d 382 (Tex. Civ. App.–Houston [14th Dist.] 1976, no writ), the court found that a guarantor under a partial or limited guaranty can direct that payments made by the *guarantor* from the guarantor's own funds be credited against the amount guaranteed. *Id*. at 386. In Warrior Constructors, a guarantor made payments on a note out of the guarantor's funds under the express condition that the funds be applied to reduce the guarantor's liability. The creditor accepted the payments under these conditions. The court held that the creditor was bound to apply the payments as instructed and stated, "[T]he cashing of [guarantor's] checks by [creditor] was such an exercise of dominion over the funds as to constitute acceptance of the conditions on which they were offered." *Id*. A creditor, therefore, appears to be bound by payments made by a guarantor from the guarantor's own funds with instructions that the payments be applied to reduce the guarantor's liability under a limited guaranty. *See id*.

[67] The intent of the last two sentences in this Section 2.4 is to (i) preclude Guarantor from asserting a defense that its liability under this Guaranty is somehow limited or offset by the terms of another guaranty executed by Guarantor in favor of Lender, and (ii) affirm that Guarantor may have additional liability to Lender under the Loan if it serves as a general partner or managing member of Borrower or has some other capacity that may create additional liability to Lender.

[68] Many of the defenses available to a guarantor under the general principles of suretyship can be waived if properly drafted in a guaranty. Generally, a waiver of a guarantor's defenses will be enforceable if it can be shown that the waiver is an intentional relinquishment of a known right, or there is intentional conduct that is inconsistent with a known right. *See* Sun Exploration v. Benton, 728 S.W.2d 35, 37 (Tex. 1987). Waiver can be inferred from conduct, but courts will first look at the language of the guaranty to determine the extent of waiver. *See* Hopkins v. First Nat'l Bank at Brownsville, 551 S.W.2d 343, 345 (Tex. 1977); First Bank of Houston v. Bradley, 702 S.W.2d 683, 686 (Tex. App.–Houston [14th Dist.] 1997, no writ). In Zurich Gen. Accident & Liab. Ins. Co. v. Fort Worth Laundry Co., 63 S.W.2d 236, 237 (Tex. Civ. App.–Fort Worth 1933, no writ), the court said "[t]he doctrine of waiver from its nature, is applicable, generally speaking, to all rights or privileges to which a person is legally entitled, whether secured by contract, conferred by statute, or guaranteed by the constitution." Surety defenses that can be waived include: **Release of Borrower**: *See* first annotation to Section 3.1(a)(vi) (Certain Agreements and Additional Waivers by Guarantor), *infra*. **Material Alteration of Underlying Obligation**: *See* annotation to Section 3.1(a)(viii) (Certain Agreements and Additional Waivers by Guarantor), *infra*. **Impairment of Collateral**: *See* annotation to Section 3.1(a)(v) (Certain Agreements and Additional Waivers by Guarantor), *infra*. **Impairment of Recourse; Tender of Performance**: *See* first annotation to Section 2.2 (Guaranty of Performance), *supra*. Claims of **fraudulent inducement and negligence** may also be waived, but the language of the waiver is critical. *See* annotation to Section 3.1(a)(xiii) (Certain Agreements and Additional Waivers by Guarantor), *infra*, and annotation to Section 4.1(j) (Representations and Warranties of Guarantor), *infra*. Furthermore, although a guarantor cannot

of the following before Guarantor is obligated to pay or perform the Guaranteed Obligations or before Lender may proceed against Guarantor: (A) sue or exhaust remedies against Borrower or any other Person liable for the Guaranteed Obligations or any portion thereof;[70] (B) sue on an accrued right of action in respect of any of the Guaranteed Obligations or bring any other action, exercise any other right, or exhaust any other remedy;[71] or (C) enforce rights against Borrower's assets or the collateral pledged by Borrower to secure the Guaranteed Obligations;[72] (iii) any right relating to the timing, manner or conduct of Lender's enforcement of rights against

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waive its **statute of limitations** defense, it cannot assert the borrower's statute of limitations defense to defeat a claim on its guaranty. *See* annotation to Section 3.1(a)(iii) (Certain Agreements and Additional Waivers by Guarantor), *infra.*

Texas courts routinely waivers of a guarantor's rights, if property drafted, such as the right to require that the borrower be joined in a suit against the guarantor, presentment, demand for payment, notice of dishonor, notice of intent to accelerate and notice of acceleration (Shumway v. Horizon Credit Corp., 801 S.W.2d 890, 893 (Tex. 1991); Star Food Processing, Inc. v, Killian, 954 S.W.2d 124, 126 (Tex. App.—San Antonio 1997, pet. denied); Phillips v. Allums, 882 S.W.2d 71, 74 (Tex. App.–Houston [14th Dist.] 1994, writ denied); Sylvester v. Watkins, 538 S.W.2d 827, 832 (Tex. Civ. App.–Amarillo 1976, writ ref'd n.r.e.); Miller v. Gordon, 284 S.W.2d 806, 807 (Tex. Civ. App.–Dallas 1955, writ ref'd n.r.e.).

Certain rights cannot be waived, such as those rights and benefits flowing to a third party from a statute or other legal or equitable source cannot be waived, rights that do not exist at the time a guarantor enters into the waiver or that are not known at the time of the waiver; or rights that should not be waived do to public policy reasons, such as the statute of limitations. *See* United Benefit Fire Ins. Co. v. Metro. Plumbing Co., 363 S.W.2d 843, 847 (Tex. Civ. App.–El Paso 1962, no writ); Cent. Am. Life Ins. Co. v. Krause, 284 S.W.2d 192, 194 (Tex. Civ. App.–Amarillo 1955, no writ); Pennzoil v. Socony Mobil Oil Co., 421 S.W.2d 416, 423 (Tex. Civ. App.–El Paso 1967, writ dism'd); Simpson v. McDonald, 179 S.W.2d 239, 243 (Tex. 1944).

[69] *See* second annotation to Section 2.1 (Guaranty of Payment), *supra*.

[70] A guarantor that executes an absolute, unconditional guaranty implicitly waives any requirement that the lender must take action against the borrower as a condition a precedent to guarantor's liability unless the guaranty expressly states otherwise. *See* Bishop v. Nat'l Loan Investors, L.P., 915 S.W.2d at 241, 244 (Tex. App.—Fort Worth 1995). *See also* first and fourth annotations to Section 2.1 (Guaranty of Payment), *supra*, first annotation to Section 2.2 (Guaranty of Performance), *supra*, last annotation to Section 2.3(a) (Primary Liability of Guarantor), *supra*, and third and fourth annotations to Section 2.3(b) (Primary Liability of Guarantor), *supra*.

[71] A guarantor can waive the right to have the lender pursue other remedies before pursuing the guarantor. *See* Universal Metals & Mach., Inc. v. Bohart, 539 S.W.2d 874, 877 (Tex. 1976). *See also* last annotation to Section 2.3(a) (Primary Liability of Guarantor), *supra*, and third and fourth annotations to Section 2.3(b) (Primary Liability of Guarantor), *supra*.

[72] Where real property secures the underlying promissory note, a guarantor can waive the right to have the lender foreclose on the mortgaged property before pursuing the guarantor. *See* F.D.I.C. v. Coleman, 795 S.W.2d 706, 710 (Tex. 1990). Likewise, when personal property secures the note, a guarantor can waive the right to have the lender dispose of the borrower's collateral before pursuing the guarantor. *See* SEI Bus. Sys., Inc. v. Bank One Tex., N.A., 803 S.W.2d 838, 840 (Tex. App.–Dallas 1991, no writ). *See also* third and fourth annotations to Section 2.3(b) (Primary Liability of Guarantor), *supra*, and annotation to Section 3.1(a)(v) (Certain Agreements and Additional Waivers by Guarantor), *infra*.

Borrower's assets or the collateral pledged by Borrower to secure the Guaranteed Obligations;[73] (iv) if Guarantor and Borrower (or any other Person) have each pledged assets to secure the Guaranteed Obligations, any right to require Lender to proceed first against collateral pledged by Borrower (or any other Person) before proceeding against the collateral pledged by Guarantor;[74] (v) promptness, diligence, notice of any Default, notice of nonpayment or nonperformance, notice of acceleration or intent to accelerate, **[demand for payment or performance] [(although Lender may, but shall have no obligation to, make demand for payment or performance)]**, acceptance or notice of acceptance of this Guaranty, presentment, notice of protest, notice of dishonor, notice of the incurring by Borrower of additional indebtedness, notice of any suit or other action by Lender against Borrower or any other Person, any notice to any Person liable for the obligation that is the subject of the suit or action, and all other notices and demands with respect to the Guaranteed Obligations and this Guaranty;[75] (vi) each of the foregoing rights or defenses, regardless of whether they arise under (A) Rule 31 of the Texas Rules of Civil Procedure, (B) Section 17.001 of the Texas Civil Practice and Remedies Code, (C) Chapter 43 of the Texas Civil Practice and Remedies Code,[76] or (D) any other statute or Law, common law, in equity, under contract or otherwise, or under any amendments, recodifications, supplements or any successor statute or Law of or to any such statute or Law; and (vii) any and all rights under Sections 51.003, 51.004 and 51.005 of the Texas Property

[73] Guarantors of a note secured by real property do not enjoy the right to notice of a foreclosure sale. *See* Bishop, 915 S.W.2d at 245; Long, 882 S.W.2d at 866. With respect to a note secured by personal property (which is governed by Article 9 of the UCC), a lender is barred from pursuing deficiency claims against a guarantor unless the guarantor is provided notice of the foreclosure sale. *See* Bishop, 915 S.W.2d at 245; Hernandez v. Bexar County Nat'l Bank of San Antonio, 710 S.W.2d 684, 687 (Tex. App.—Corpus Christi 1986). Under former Article 9, it was clear that a guarantor was entitled to notice of the disposition of collateral, and prior to default this right could not be waived. *See* TEX. BUS. & COM. CODE § 9.504(c) (West 1991). The same principles are incorporated into two provisions in the revised Article 9, which became effective July 1, 2001. *See* TEX. BUS. & COM. CODE. ANN. § 9.611(c) (West 2002) (guarantor is defined as secondary obligor under § 9.102(60) and entitled to notice of disposition of collateral under 9.611(c)); TEX. BUS. & COM. CODE. § 9.612 (West 2010) (debtor can waive notice of disposition after default). Former § 9.501(c) of the Texas Business and Commerce Code prohibited a guarantor from waiving the duty of a lender in possession of collateral to dispose of collateral in a commercially reasonable manner. *See* Rabinowitz v. Cadle Co. II, Inc., 993 S.W.2d 796, 800 (Tex. App.–Dallas 1999, pet. denied). *But see* Steinberg v. Cinema N'Drafthouse Sys., Inc., 28 F.3d 23, 25 - 26 (5th Cir. 1994) (concluding that Texas Supreme Court would not apply § 9.501(c) to a guarantor). Under the revised Article 9, the anti-waiver provisions of Section 9.501(c) are now codified at Section 9.602. Applying the reasoning of Rabinowitz, a guarantor should not be able to waive any of the items explicitly listed in Section 9.602. *See also* last annotation to this Section 2.5 (Waivers), *infra*, for a discussion of the anti-deficiency statute, and last annotation to Section 2.3(b) (Primary Liability of Guarantor), *supra*, regarding a lender's right to act as the purchaser at a foreclosure sale.

[74] *See* annotation to clause (ii)(C) of this Section 2.5 (Waivers), *supra*.

[75] As a general rule, any defense or right can be waived. *See* Lorin Williams Combs, John M. Nolan and Edward A. Peterson, Waiver and the Quest for Lender Protection, presented at the 37th Annual William W. Gibson, Jr. Mortgage Lending Institute (2003). *See also* sixth annotation to Section 2.1 (Guaranty of Payment), *supra*, second annotation to Section 2.2 (Guaranty of Performance), first annotation to this Section 2.5 (Waivers), *supra*, and annotation to Section 3.1(a)(xiii) (Certain Agreements and Additional Waivers by Guarantor), *infra*.

[76] *See* last annotation to Section 2.3(a) (Primary Liability of Guarantor), *supra*.

Code, and under any amendments, recodifications, supplements or any successor statute or Law of or to any such statute or Law.[77]

2.6 Term of Guaranty. This Guaranty shall continue in effect until all the Guaranteed Obligations are fully and finally paid, performed, satisfied and discharged, except that, and notwithstanding any return of this Guaranty to Guarantor, this Guaranty shall continue in effect (i) with respect to any of the Guaranteed Obligations that survive the full and final payment of the indebtedness evidenced by the Note or the discharge of the Guaranteed Obligations, (ii) with respect to all obligations and liabilities of Guarantor under Section 6.6 of this Guaranty, and (iii) as provided in Section 3.1(b) of this Guaranty.

ARTICLE III
EVENTS AND CIRCUMSTANCES NOT REDUCING OR DISCHARGING GUARANTOR'S OBLIGATIONS

3.1 Certain Agreements and Additional Waivers by Guarantor.[78]

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[77] Sections 51.003, 51.004 and 51.005 of the Texas Property Code (which Section 51.005 is often referred to as the "guarantor anti-deficiency statute") allow a guarantor to challenge the sale price of real property at a foreclosure sale and to obtain a credit against the deficiency for the amount by which the trier of fact determines the fair market value at the time of the sale exceeded the successful bid. *See* TEX. PROP. CODE ANN. §§ 51.003-005 (West 2010). Although Sections 51.003, 51.004 and 51.005 of the Texas Property Code are silent as to waiver, the Fifth Circuit has held that guarantor of mortgage debt may waive its statutory right in Section 51.003 of the Texas Property Code to offset the difference between the fair market value of the mortgaged property at the time of foreclosure and the foreclosure sales price against its liability to the lender for a deficiency. LaSalle Bank, N.A. v. Sleutel, 289 F.3d 837 (5th Cir. 2002). In addition, at least one Texas court has upheld a guarantor's waiver of a fair market valuation as provided in Section 51.005 of the Texas Property Code. *See* Segal v. Emmes Capital, L.L.C., 155 S.W.3d 267 (Tex. App.—Houston [1st Dist.] 2004, pet. abated). *See* Annotated Deed of Trust, annotations to Section 7.8 (Waiver of Deficiency Statute), for a general discussion of sections 51.003, 51.004 and 51.005 and of a borrower's waiver of the rights granted by such statutes. *See also* last annotation to Section 2.3(b) (Primary Liability of Guarantor), *supra*, regarding a lender's right to act as the purchaser at a foreclosure sale.

[78] In general, a guarantor may not be liable if the principal is not liable. *See* Savin Corp. v. Copy Distrib. Co., Inc., 716 S.W.2d 690, 692 (Tex. App.—Corpus Christi 1986, no writ). As a general rule, a guarantor can assert the same defenses that a borrower could assert. *See* Wiman v. Tomaszewicz, 877 S.W.2d 1, 6 (Tex. App.–Dallas 1994, no writ); Stephens v. First Bank and Trust of Richardson, 540 S.W.2d 572, 574 (Tex. Civ. App.–Waco 1976, writ ref'd n.r.e.); Mayfield v. Hicks, 575 S.W.2d 571, 574 (Tex. Civ. App.—Dallas 1978, writ ref'd n.r.e.); Berliner Handels-Und Frankfurter Bank (In re East Tex. Steel Facilities, Inc.), 117 B.R. 235 (Bankr. N.D. Tex. 1990).

Some defenses, however, are considered **"personal defenses" belonging only to the borrower**, and are unavailable to a guarantor. For example, courts have held guarantors liable even when the underlying obligation was unenforceable against the borrower because: (i) the interest on the underlying debt violated **usury** laws (*see* Houston Sash & Door Co. v. Heaner, 577 S.W.2d 217, 222 (Tex. 1979); Micrea, Inc. v. Eureka Life Ins. Co. of Am., 534 S.W.2d 348, 354 (Tex. Civ. App.–Fort Worth 1976, writ ref'd n.r.e.); *see also* annotation to clause (D) in Section 3.1(a)(xv) (Certain Agreements and Additional Waivers by Guarantor), *infra*, annotation to Section 6.6 (Attorneys' Fees and Costs of Collection), *infra*, and annotation to Section 6.17 (Controlling Agreement), *infra*); (ii) the borrower's signature was a **forgery** (*see* Universal Metals & Mach., Inc. v. Bohart, 539 S.W.2d 874, 877) (Tex. 1976); (iii) the borrower's incurrence of the underlying debt was ***ultra vires*** (*see* Nat'l City Bank of St. Louis, Mo. v. Taylor, 293 S.W. 613, 618 (Tex. Civ. App.–Texarkana 1927, no writ); or (iv) the **statute of limitations** barred action against the borrower (*see* Beddall v. Reader's Wholesale Distribs., Inc., 408 S.W.2d 237 (Tex. Civ. App.—Houston 1966, no writ); Wiman, 877 S.W.2d at 7; *see also* annotation to Section 3.1(a)(iii) (Certain

(a) Guarantor hereby agrees that neither Lender's rights or remedies nor Guarantor's obligations under the terms of this Guaranty shall be released, diminished, impaired, reduced or affected in any way by any one or more of the following events, actions, facts or circumstances, and the liability of Guarantor under this Guaranty shall be absolute and unconditional irrespective of:

(i) any limitation of liability or recourse against, or other exculpation from liability of, Borrower or any other Person in any other Loan Document or arising under any Law;[79]

(ii) any claim or defense that this Guaranty was made without consideration or is not supported by adequate consideration;[80]

Agreements and Additional Waivers by Guarantor), *infra*. Consequently, the legal liability on the part of the borrower is not a prerequisite to liability of the guarantor. *See* Nat'l City Bank of St. Louis, Mo., 293 S.W. at 618.

Significantly, each of the foregoing cases involved absolute, unconditional guaranties (*i.e.*, payment guaranties) rather than conditional or collection guaranties. In many of these cases, however, the court did not clearly make this distinction as a basis for their opinion and did not indicate how its ruling would apply to a collection guaranty. The question thus arises as to whether the holdings in these cases would also apply to a collection guaranty or, rather, only to payment guaranties. Based on the facts in each of these cases and the corresponding court decisions, one can reasonably conclude that a guarantor under a payment guaranty remains liable as a primary obligor without the benefit of these personal defenses of the borrower. *See, e.g.*, United States v. Little Joe Trawlers, Inc., 776 F.2d 1249, 1252 (5th Cir. 1985) (stating that an unconditional guarantor can be liable for payment even though the holder of the note cannot enforce the claim against the principal). *See* also Axial v. Robles, No. EP-07-CV-269-KC, 2010 WL 2900991 (W.D.Tex., July 21, 2010) (finding that a lease guarantor could be liable to landlord, even if lease was unenforceable against the tenant). This conclusion is not evident, however, with respect to a collection guaranty. Rather, the more accurate presumption might be that a guarantor of collection (depending on the facts of the case) may be able to assert these defenses under the general rule noted above. Accordingly, lenders should be aware that even these defenses "personal" to a borrower might still be available to a guarantor under a collection guaranty.

See also annotations to Section 3.1(a)(xv) (Certain Agreements and Additional Waivers by Guarantor), *infra*.

[79] The fact that a debt is **non-recourse** as to the borrower does not change the fact that the borrower is in debt, and although the borrower cannot be held liable for the debt, there is still indebtedness for which the guarantor is liable. *See* RTC v. Northpark Joint Venture, 958 F.2d 1313, 1320 (5th Cir. 1992) *cert. denied*, 506 U.S. 1048 (1993). Where a guaranty is a continuing guaranty that includes renewals and extensions, the guarantor is not relieved from liability even if the nature of the loan is changed from recourse to non-recourse. *See* Travelers Ins. Co. v. Bosler, 906 S.W.2d 635, 642 - 43 (Tex. App.–Fort Worth 1995, writ denied), *vacated by agreement on motion for rehearing,* 938 S.W.2d 716 (Tex. 1997). *See also* third annotation to Section 2.1 (Guaranty of Payment), *supra*. In Bosler, the court held that a modification agreement that changed the nature of the limited partnership borrower's obligation from a full recourse to a non-recourse obligation and that expressly provided that neither the partnership nor its partners would have any personal liability for the debt, only absolved the maker of the note and its partners (in their capacity as partners) from personal liability, but the non-recourse provisions did not affect the guarantors' personal liability for the entire indebtedness, even though all of the guarantors were limited partners in the borrower. *Id.* at 643. The Bosler court also noted that the fact that the guarantors were partners of the borrower did not extend the non-recourse provision to their "separate and distinct obligations as guarantors." *Id.*

See also first annotation to Section 3.1(a)(vi) (Certain Agreements and Additional Waivers by Guarantor), *infra*.

(iii) any statute of limitations in any action hereunder for the collection of the Note or for the payment or performance of any or all of the Guaranteed Obligations;[81]

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[80] *See* annotations to Paragraphs B. and C. in the Recitals to this Guaranty, *supra*, for a discussion of consideration.

[81] If a lender fails to take action against a borrower until after the **statute of limitations** runs, then under the Third Restatement of Suretyship and Guaranty, the lender generally cannot pursue a guarantor on its guaranty. The Third Restatement of Suretyship and Guaranty provides that once the statute runs against the principal, it is as though a release of the guarantor has been made (unless certain unique circumstances exist as discussed in the Restatement). *See* RESTATEMENT (THIRD) OF SURETYSHIP AND GUARANTY § 43 (1996). Part of the argument is that a lender should not sit idly by, but, rather, should file suit against the guarantor as soon as practicable, particularly when it can do so without filing suit against the principal.

However, Texas follows the majority rule that when a guarantor can be sued independently from the borrower (as under a guaranty of payment), the guarantor cannot assert the borrower's statute of limitations defense to defeat a claim against the guarantor. *See* Wiman, 877 S.W.2d at 7. Payment guarantors are principal obligors on the indebtedness, and the running of the statute of limitations against the borrower does not affect the undertaking of such a guarantor. *Id*. at 5.

The holding in Wiman is based on an unconditional guaranty of payment. Under a collection guaranty, the borrower must be sued previously to or concurrently with the guarantor unless certain exceptions apply. *See* first and fourth annotations to Section 2.1 (Guaranty of Payment), *supra*, and last annotation to Section 2.3(a) (Primary Liability of Guarantor), *supra*. Also, a surety or a guarantor is traditionally entitled to rely upon all defenses available to their principal as to the debt owed. *See* Great Am. Ins. Co. v. N. Austin Mun. Util. Dist. No. 1, 908 S.W.2d 415, 419 (Tex. 1995); Mayfield v. Hicks, 575 S.W.2d at 574. *But see* first annotation to this Section 3.1 (Certain Agreements and Additional Waivers by Guarantor), *supra*. Based on the foregoing, lenders should be aware that a collection guarantor may be able to assert the statute of limitations defense as it applies to the principal. For example, if the lender fails to bring suit against the borrower before the statute of limitations expires, then a guarantor under a collection guaranty could feasibly argue that (i) the holding in Wiman should be limited only to payment guaranties, and (ii) such failure obviously did not constitute "reasonable diligence" to collect the debt from the borrower. *See* fourth annotation to Section 2.1 (Guaranty of Payment), *supra*.

Although a guarantor may be unable to assert the borrower's statute of limitations defense, any guarantor may assert its own statute of limitations defense as an affirmative defense to discharge the guarantor. *See* TEX. R. CIV. P. 94 (West 2010). Unlike most surety/guarantor defenses, the statute of limitations defense cannot be waived in Texas. An agreement in advance to waive or not plead the statute of limitations is void against public policy in Texas. *See* Simpson v. McDonald, 179 S.W.2d 239, 243 (Tex. 1944); Squyres v. Christian, 253 S.W.2d 470, 472 (Tex. Civ. App.–Fort Worth, 1952, writ ref'd n.r.e.). A person must bring suit on a debt, including a suit against a guarantor, no later than four years after the day the cause of action accrues. TEX. CIV. PRAC. & REM. CODE ANN. § 16.004(a)(3) (West 2010). A court must decide the question of when an action accrues. *See* Wiman, 877 S.W.2d at 5. Parties can shorten the applicable statute of limitations within certain limits. Section 16.070 of the Texas Civil Practice and Remedies Code expressly provides that "a person may not enter a stipulation, contract, or agreement that purports to limit the time in which to bring suit on the stipulation, contract, or agreement to a period shorter than two years. A stipulation, contract, or agreement that establishes a limitations period that is shorter than two years is void in this state." TEX. CIV. PRAC. & REM. CODE ANN. § 16.070(a) (West 2010). *See also* U.S. Fidelity & Guar. Co. v. E. Hills Methodist Church, 609 S.W.2d 298, 300 (Tex. Civ. App.–Fort Worth 1980, writ ref'd n.r.e.) (contract requiring the filing of suit before the expiration of two years was void because the time period provided in the contract failed to comply with Texas Civil Practice and Remedies Code § 16.070(a)). If, however, the stipulation, contract, or agreement relates to the sale or purchase of a business entity and if a party to the stipulation, contract, or agreement pays or receives the aggregate value of not less than $500,000.00 in

(iv) the taking or accepting of any other security, collateral or guaranty, or other assurance of payment for, or right of recourse with respect to, any or all of the Guaranteed Obligations;

(v) any release, surrender, abandonment, exchange, substitution, alteration, sale or other disposition, subordination, deterioration, waste, failure to protect or preserve, impairment (including without limitation, **NEGLIGENT**, willful, unreasonable or unjustifiable impairment), or loss of, or any failure to create or perfect any lien or security interest with respect to, or any other dealings with, any collateral or security at any time existing or purported, believed or expected to exist in connection with any or all of the Guaranteed Obligations, including any impairment of Guarantor's recourse against any Person or collateral;[82]

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consideration, then the parties may agree to a limitations period shorter than two years. *See* TEX. CIV. PRAC. & REM. CODE ANN. § 16.070(b) (West 2010).

The terms of the guaranty control when the statute of limitations begins to run against the guarantor. *See* Wiman, 877 S.W.2d at 5-6. Typically, under an absolute and unconditional guaranty, the limitations period against the guarantor will begin to run at the same time as the borrower's and run concurrently. *See id*. at 7. Under a conditional guaranty or collection guaranty, the statute of limitations will not begin to run against the guarantor until all conditions triggering the guarantor's liability have been fulfilled (and thus may not run concurrently with that of the borrower). *See id*. at 6.

[82] **Impairment of collateral** is another defense available to a surety/guarantor. Impairment of collateral is generally any act or omission that lessens the surety/guarantor's expected recovery from the collateral through subrogation. This includes such things like diminution in the value of real property or failure to sell stock at a time when the market is "up," or failure to perfect a security interest. *See* RESTATEMENT (THIRD) OF SURETYSHIP AND GUARANTY § 42 (1996). If the obligee diminishes the value of the collateral by some act or failure to act, the surety/guarantor is usually discharged to the extent that the failure caused a loss, measured by the reduction of the value of the interest in the collateral compared to the obligation it secures. *See id*. at comment g. A guarantor, however, can waive its ability to complain about lender's impairment of collateral. *See* Simpson v. MBank Dallas, N.A., 724 S.W.2d 102, 106, Tex. App.–Dallas 1987, writ ref'd n.r.e) (an unconditional, continuing guaranty is binding upon the guarantor regardless of any impairment of collateral). In F.D.I.C. v. Coleman, a guarantor unsuccessfully alleged that the F.D.I.C.'s deficiency claim should be rejected because it failed to sell real property securing the guaranteed note at the proper time and the property decreased in value. The court held that a secured creditor owes no duty of good faith to a guarantor. *See* F.D.I.C. v. Coleman, 795 S.W.2d 706, 708 (Tex. 1990). The court reasoned that even if a duty did exist, the waiver provisions of the guaranty precluded the guarantor from complaining about the creditor's disposal of the collateral. *See id*. at 710. *See also* Smith v. U.S. Nat'l Bank of Galveston, 767 S.W.2d 820, 823 (Tex. App.–Texarkana 1989, writ denied) (waiver provision of guaranty prevents guarantor from complaining about creditor's actions with respect to the impairment of real property collateral). The same principles have been applied to a creditor's obligations with respect to personal property. *See* SEI Business Sys., Inc. v. Bank One Tex., N.A., 803 S.W.2d 838, 840 (Tex. App.—Dallas 1991, no writ) (creditor owes no duty to sell personal property collateral at a time most favorable to guarantor and guarantor waived right to complain about creditor's disposition of the collateral). *But see* last annotation to Section 2.5 (Waivers), *supra*, regarding the right of a guarantor to challenge the sale price of real property at foreclosure. If impairment of collateral is waived by the guarantor as a defense, then the guarantor will likely not be able to assert a defense that the lender's actions have diminished the value of the collateral for the loan. *See T.O Stanley Boot Co.*, 847 S.W.2d at 223-224 (The bank obtained possession of the collateral through an injunction but failed to maintain the alarm system for the premises and during such time the collateral was devalued due to vandalism that allegedly would have been prevented by a functioning alarm system).

(vi) whether expressly done or by operation of Law, any full or partial release of the liability of Borrower on the Guaranteed Obligations,[83] or any part thereof, or of any co-guarantors, or any other Person now or hereafter liable, whether directly or indirectly, jointly, severally, or jointly and severally, to pay, perform, guarantee or assure the payment or performance of the Guaranteed Obligations, or any part thereof, it being recognized, acknowledged and agreed by

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[83] Generally, a **release** of the primary obligor also releases the guarantor. *See* In re El Paso Refining, Inc., 192 B.R. 144, 148 (Bankr. W.D. Tex., 1996). A guarantor's liability on a debt is measured by the principal's liability, unless a more extensive or a more limited liability is expressly set forth in the guaranty agreement. *See* Houston Furniture Distribs., Inc. v. Bank of Woodlake, N.A., 562 S.W.2d 880, 884 (Tex. Civ. App.–Houston [1st Dist.] 1978, no writ); Textron Fin. Corp. v. Anchor Marine & Tackle, 2010 WL 2991068 (W.D. Tex. Jul 26, 2010). That which discharges the principal from his obligation also exonerates the surety, unless made with the surety's consent and to his prejudice. *See* Metze v. Entman, 584 S.W.2d 512, 514 (Tex. Civ. App.–Houston [14th Dist.] 1979, no writ). A guarantor can only be held liable for the debt of his principal, and any release of his principal by substituting another principal, or otherwise, releases the guarantor. *See* May v. Waniger, 164 S.W. 1106 (Tex. Civ. App.–San Antonio 1914, no writ). In Eastman Oil Well Survey Co. v. Hamil, 416 S.W.2d 597 (Tex. Civ. App.–Houston 1967, writ ref. n.r.e.), the court implied, by disagreement with appellant's argument, that if the letter in issue released the primary obligor, then appellee, as guarantor and not co-obligor, would also be released.

However, a release of the principal obligor does not always constitute a release of the guarantor. If the lender intends to release or discharge all claims against all involved parties, as in an accord and satisfaction, the guarantor will also be released. If, on the other hand, the lender intends to release only the borrower, and outwardly manifests the intent to continue to pursue the guarantor, the guarantor is not released or may be released only to the extent the guarantor can show that it will suffer a loss as a result of the borrower's release. *See* RESTATEMENT (THIRD) OF SURETYSHIP & GUARANTY § 39 (1996). Case law supports this general proposition. In Bosler, the Court determined that (i) if a release discharges the underlying debt, the guarantor is also discharged by the release, but (ii) if the release discharges only the borrower (as opposed to the underlying debt), the guarantor is not released from its obligations. *See* Bosler, 906 S.W.2d at 642-43. The Bosler court ruled that only the borrower and its partners were absolved from personal liability where (i) the borrower's obligation was modified from full recourse to non-recourse, and (ii) the partnership and its partners were to no longer have any personal liability for the debt. *Id*. The personal liability of the guarantors for the full amount of the debt remained unaffected, however, and, therefore, the guarantors were still liable on their guaranty. *Id*. *See also* annotation to Section 3.1(a)(i) (Certain Agreements and Additional Waivers by Guarantor), *supra*. Based on the foregoing analysis, one way to avoid releasing a guarantor is to expressly provide in the release document that the lender releases only the borrower and not the guarantor. Another method is to provide, up front in the guaranty itself, as in this Section 3.1(a)(vi), that any release by the lender of the borrower does not release the guarantor. *See* RESTATEMENT (THIRD) OF SURETYSHIP & GUARANTY § 39 (1996); In re El Paso Refining, Inc., 192 B.R. at 148.

These concepts are generally supported by principals of suretyship. A secondary obligation may be larger or more burdensome than the underlying obligation so long as performance of the underlying obligation discharges the secondary obligation. *See* RESTATEMENT (THIRD) OF SURETYSHIP AND GUARANTY § 1 (1996). The Restatement recognizes that the general rules as to the effect of suretyship status may be varied by agreement between the parties. Thus, a lender and a guarantor may, subject to the general tenets of contract law as to conscionability and legality, include in a guaranty any terms they may find desirable.

See also annotation to Section 3.1(a)(vii) (Certain Agreements and Additional Waivers by Guarantor), *infra*, discussing the bankruptcy of the borrower will not release the guarantor.

See also first annotation to this Section 3.1 (Certain Agreements and Additional Waivers by Guarantor), *supra*, and annotations to Section 3.1(a)(xv) (Certain Agreements and Additional Waivers by Guarantor), *infra*, discussing defenses personal only to a borrower which will not result in discharge of a guarantor.

Guarantor that Guarantor may be required to pay or perform the Guaranteed Obligations in full without assistance or support of any other Person, and Guarantor has not been induced to enter into this Guaranty on the basis of a contemplation, belief, understanding or agreement that any other Person will be liable to pay or perform the Guaranteed Obligations, or that Lender will look to other any other Person to pay or perform the Guaranteed Obligations;[84]

(vii) the filing of a petition or the institution of any proceeding or action by or against Borrower, Guarantor or any other Person pursuant to any Debtor Relief Law, or the **[*for individual:* death or disability] [*for entity:* dissolution, merger, consolidation, change of form, structure or ownership, or lack of corporate, partnership or other organizational power]** of Borrower, Guarantor or any other Person at any time liable for the payment or performance of all or part of the Guaranteed Obligations; or any sale, lease or transfer of any assets of Borrower, Guarantor or any other Person at any time liable for the payment or performance of all or part of the Guaranteed Obligations;[85]

(viii) either with or without notice to or consent of Guarantor: (A) any renewal, extension, modification, increase, supplement, subordination or rearrangement of the terms of any or all of the Guaranteed Obligations or any of the Loan Documents, including, without limitation, material alterations of the terms of payment (including changes in maturity date[s] and interest rate[s]), the amount of the Guaranteed Obligations (including any increases in the amount of the Guaranteed Obligations), or performance or any other terms thereof; (B) any waiver, termination, or release of, or consent to departure from, any of the Loan Documents or any other guaranty of any or all of the Guaranteed Obligations; or (C) any adjustment, indulgence, forbearance or compromise that may be granted

[84] *See* annotations to Section 2.1 (Guaranty of Payment), *supra*. *See also* annotations to Section 6.3 (Binding Effect), *infra*.

[85] The general principle that a debtor's discharge in bankruptcy does not affect the obligations of third party non-debtors is well established. *See* 11 U.S.C. § 524(e) (2009). *See also* In re Sandy Ridge Dev. Corp., 881 F.2d 1346, 1351 (5th Cir. 1989) (holding that a discharge in bankruptcy of a principal will not release the guarantor of its obligation on the debt); *but see* Weaver v. Tex. Cap. Bank, N.A., No. 3:09-CV-380-M, 2010 WL 3119397, at *3 (N.D. Tex., Aug 5, 2010) (noting that a surrender of real property by a borrower to lender *in full satisfaction* of the bank's claims could satisfy a guarantor's obligation to the bank) (emphasis added). Bankruptcy courts have disagreed, however, as to whether this general principle could be overridden by a temporary or preliminary injunction granted for the benefit of third party guarantors in a plan of reorganization under chapter 11. *See* In re Seatco, 257 B.R. 469 (Bankr. N.D. Tex. 2001), modified at 259 B.R. 279; Bernhard Steiner Pianos USA, Inc., 292 B.R. 109 (Bankr. N.D. Tex. 2002). Other courts have refused to allow confirmation of plans that provide for the release or modification of claims against non-debtor third parties. *See, e.g.*, In re Lowenschuss, 67 F.3d 1394, 1401 (9th Cir.1995) (holding that § 524(e) precludes bankruptcy courts from discharging the liabilities of non-debtors); In re Davis Broadcasting, Inc., 176 B.R. 290, 292 (M.D.Ga.1994) (finding that bankruptcy court lacked authority to confirm debtor's proposed Chapter 11 plan that required post-confirmation stay of all proceedings against non-debtor parties). At least in the Fifth Circuit, significant doubt currently exists as to whether a bankruptcy court has authority to enjoin or release any claims between non-debtor parties through a plan, although the Fifth Circuit has not foreclosed the possibility. *See* In re Pacific Lumber Co., 584 F.3d 229 (5th Cir. 2009).

from time to time by Lender to Borrower, Guarantor any other Person at any time liable for the payment or performance of any or all of the Guaranteed Obligations;[86]

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[86] One of the basic tenets of surety law is that if the underlying obligation is materially changed from the obligation the surety originally undertook, the surety is discharged from responsibility. In Texas, to prevail on a defense of **material alteration**, the surety/guarantor must show (i) the existence of material alteration to the underlying contract, (ii) lack of consent to the alteration, and (iii) harm resulting from the alteration. *See* Old Colony Ins. Co. v. City of Quitman, 352 S.W.2d 452, 455 (Tex. 1961). The test for determining whether an alteration is "material" is "whether the altered writing described a contract entered into by the parties, or that the instruments legal effect has varied." Spin-Line Co. v. United Concrete Pipe Co., 420 S.W.2d 744, 751 (Tex. Civ. App.–Dallas 1967), *aff'd in part, rev'd in part*, 430 S.W.2d 360 (Tex. 1968). If a change has been made to a document for the sole purpose of correcting a clerical error, so as to allow the instrument to accurately reflect the original intentions of the parties, the change is not a material alteration under Texas law. *See* Frost Nat'l Bank v. Burge, 29 S.W.3d 580, 590 (Tex. App.–Houston [14th Dist.] 2000, no pet.). A guarantor may also be discharged from its obligations if a creditor fraudulently conceals pertinent facts that it knew before the obligation was undertaken, the facts materially increase the risk of the obligor, and the creditor had adequate time to disclose them but failed in its responsibility. *See* St. Paul Fire & Marine Ins. Co. v. Commodity Credit Corp., 646 F.2d 1064, 1073 (5th. Cir. 1981). *See also* annotation to Section 3.1(a)(xiii) (Certain Agreements and Additional Waivers by Guarantor), *infra*.

Texas courts have consistently permitted parties to be released or discharged from their obligations under an affirmative defense of material alteration. *See, e.g.*, Vastine v. Bank of Dallas, 808 S.W.2d 463, 465 (Tex. 1991) (guarantor released when prejudicial deviations from the underlying loan agreement were made without consent of the guarantor which materially increased the risk of nonperformance such that a new contract was made).

Like other defenses, however, modification of the underlying risk, or material alteration, can be waived. As a general rule, a guarantor is discharged upon a material alteration of the underlying agreement between the borrower and the lender unless the alteration is made with the guarantor's consent. *See* Vastine, 808 S.W.2d at 464-65. A guarantor can consent to the alteration in the terms of the guaranty or, alternatively, by express terms or acts at the time of the alteration, and if the guarantor so consents, the defense of material alteration is unavailable. *See* United States v. Vahlco Corp., 800 F.2d 462, 468-69 (5th Cir. 1968); F.D.I.C. v. Attayi, 745 S.W.2d 939, 944 (Tex. App.–Houston [1st Dist.] 1988, no writ). Furthermore, a guarantor under a continuing guaranty is not relieved of liability when the underlying indebtedness is renewed, modified or extended, even if it is renewed or extended without the guarantor's knowledge. *See* Adcock v. First City Bank of Alice, 802 S.W.2d 305, 307 (Tex. App.—San Antonio 1990, no writ); Brazosport Bank of Tex. v. Travis, 617 S.W.2d 729, 731 (Tex. Civ. App—Houston [14th Dist.] 1981, writ ref'd n.r.e..); *see also* third annotation to Section 2.1 (Guaranty of Payment), *supra*. A continuing guaranty by its terms contemplates future transactions in connection with the underlying indebtedness, thus a guarantor is not discharged by a material alteration that is contemplated by the terms of the guaranty. *See* GMC Enters., Inc. v. Sunwest Bank of El Paso, N.A., No. 08-99-00384-CV, at *4, 2000 WL 730780 (Tex. App.–El Paso June 8, 2000); Sonne v. F.D.I.C., 881 S.W.2d 789 (Tex. App.—Houston [14th Dist.] 1994, writ denied). Through the terms of the guaranty, a guarantor can consent up front to any future "material" alteration of the underlying indebtedness, including even an increase in the amount of the indebtedness guaranteed. *See* Sonne, 881 S.W.2d at 792. Consent by a guarantor to a material alteration is determined, however, on a case-by-case basis according to the terms of the guaranty. *See id.*

The definition of "Guaranteed Indebtedness" in Section 1.1 (Definitions) (as explained in the first annotation to such definition), *supra*, and this Section 3.1(a)(viii) attempt to create an effective consent to (*i.e.*, waiver of) any "material alteration" to the underlying indebtedness, such that Guarantor is liable under the Guaranty for the Guaranteed Indebtedness as modified or increased from time to time. Although this provision should serve as an effective waiver of the defense of "material alteration" based on the foregoing analysis, a court may nonetheless allow a guarantor to successfully assert the defense of material alteration if the underlying obligation is substantially changed. The lender could find it difficult to rely on this provision as a waiver if, for example, the

(ix) any neglect, lack of diligence, delay, omission, failure or refusal of Lender to (A) take or prosecute (or in taking or prosecuting) any action for the payment, collection or enforcement of any of the Guaranteed Obligations, or (B) foreclose or take or prosecute any action to foreclose (or in foreclosing or taking or prosecuting any action to foreclose) upon any security therefor, or (C) exercise (or in exercising) any other right or power with respect to any security therefor, or (D) take or prosecute (or in taking or prosecuting) any action in connection with any Loan Document,[87] or (E) sell or otherwise dispose in a commercially reasonable manner any collateral securing any or all of the Guaranteed Obligations (excepting only, with respect to any sale or other disposition of collateral, any such requirement imposed at the time in question by then applicable Law that may not be waived by Guarantor). Guarantor further agrees, with respect to any sale or other disposition of collateral to which Section 9.610 of the Texas Business and Commerce Code[88] or other similar Law is determined to be applicable, that ten days[89] written notice shall constitute

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principal amount of the note was increased from $1,000,000.00 to $2,000,000.00, and may find reliance impossible as a matter of equity if the principal amount of the Note was increased in an amount that was not reasonably foreseeable by the guarantor. This is a common issue as many lenders increase the loan amount during the term of the loan. In such instances, and in other situations where the underlying loan is being modified, a prudent lender would require that the guarantor execute a separate consent similar to the form attached hereto as Rider 6 (Form of Guarantor Consent), *infra*, at the time of any loan modification.

[87] An election of remedies does not occur unless a party has two or more inconsistent remedies and elects to pursue one remedy to the exclusion of the others. *See* In re Tex. Tech Univ. Health Sciences Ctr., 2 S.W.3d 27, 30 (Tex. App.–Amarillo 1999, no pet.). The underlying policy of the election of remedies doctrine is to bar a party who has obtained a specific form of remedy from obtaining a different and inconsistent remedy for the same wrong. *See id*. There is no election of remedies when a creditor pursues a right or remedy that proves unfounded and then pursues one that is allowed. *See* In re Gayle, 189 B.R. 914, 916 (Bankr. S.D. Tex. 1995). For instance, creditors must elect a remedy between judicial and nonjudicial foreclosure. *See id*. With respect to real property, however, a creditor can nonjudicially foreclose on the collateral during the pendency of a lawsuit on the note, so long as the lawsuit does not seek foreclosure of the lien. *See* French v. May, 484 S.W.2d 420, 428 (Tex. Civ. App.–Corpus Christi 1972, writ ref'd n.r.e.). *See also* Carter v. Gray, 81 S.W.2d 647, 648 (Tex. 1935) (right to recover a judgment for a debt secured by a lien on land and the right to foreclose the lien are severable; consequently, a plaintiff may elect to seek a personal judgment without foreclosing the lien or waiving the right to foreclose). With respect to debt secured by personal property, Section 9.601(c) of the Texas Business & Commerce Code provides that remedies against personal property security are cumulative and can be exercised simultaneously. TEX. BUS. & COM. CODE ANN. § 9.601(c) (West 2010). This clarifies former Texas Business & Commerce Code Section 9.501(a), which only stated that a creditor's remedies were cumulative but did not specify that they could be exercised simultaneously. *See also* annotation to Section 2.3(c) (Primary Liability of Guarantor), *supra*.

[88] A secured party may dispose of personal property subject to the Texas Uniform Commercial Code so long as the disposition is commercially reasonable. *See* TEX. BUS. & COM. CODE ANN. § 9.610 (West 2010). Notice of such disposition must be sent in a commercially reasonable manner to a guarantor. *See id.* § 9.611(c) (providing that a notice must be sent to a secondary obligor); *id*. § 9.102(a)(72) (defining secondary obligor); *id*. Comment 2.a. § 9.102 (identifying persons who may have a stake in the proper enforcement of the security interest because of their obligation to pay the secured debt as a secondary obligor).

[89] Under the recently adopted revisions to the Texas Uniform Commercial Code, in a commercial transaction, sending a notification after default and ten days or more before the earliest time of disposition set forth in the notification is a "safe harbor" for purposes of meeting the commercially reasonable requirement with respect

reasonable notification. Except for any Law applicable to any sale or other disposition of collateral that may not be waived, no provision of this Guaranty shall be construed to limit or otherwise adversely affect Lender's absolute and discretionary rights, as set forth in this Guaranty and the other Loan Documents, to release or otherwise deal or fail to deal with any such collateral without affecting or impairing Guarantor's liability hereunder;[90]

(x) any failure of Lender to notify Guarantor of any creation, renewal, extension, rearrangement, increase, modification, supplement, subordination or assignment of the Guaranteed Obligations or any part thereof, or of any Loan Document, or of any release of or change in any security or of any other action taken or refrained from being taken by Lender against Borrower or any security or other recourse or of any new agreement between Lender and Borrower, it being understood that Lender shall not be required to give Guarantor any notice of any kind under any circumstances with respect to or in connection with the Guaranteed Obligations, any and all rights to notice Guarantor may have otherwise had being hereby waived by Guarantor (excepting only any notice that is required to be given at the time in question by then-applicable Law and only if the right to receive such notice is not waivable by Guarantor under such Law); [91]

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to timeliness. *See id.* § 9.612(b). Prior to the recent revisions to the Texas Uniform Commercial Code, this safe harbor did not exist. The statute provided for "reasonable notification" and the courts interpreted reasonable notification to be that which allowed the debtor an opportunity to protect its interest in the collateral – to enable the debtor to redeem the collateral, find other buyers or otherwise ensure that the sale is a commercially reasonable one. *See* Knights of Columbus Credit Union v. Stock, 814 S.W.2d 427 (Tex. App.—Dallas 1991, writ denied).

[90] The release by a lender of a borrower's underlying obligation and the exercise of a lender's discretion to pursue a guarantor on its obligation prior to application of any collateral is discussed in more detail in the third and fourth annotations to Section 2.3(b) (Primary Liability of Guarantor), *supra*, and in the first annotation to Section 3.1(a)(vi) (Certain Agreements and Additional Waivers by Guarantor), *supra*. While such waivers are enforceable, these rights should be exercised in a commercially reasonable manner. Although a lender's rights may be "absolute," much can be made of equitable defenses. Simply stating that the rights are "absolute" and "unconditional" is not enough. A cautious drafter needs to provide some expression of the right and the fact that it is being waived – so that the guarantor cannot later argue that there was not an intentional or purposeful relinquishment of a *known* right. Many courts take seriously allegations of unconscionability and overreaching. When a lender can, with minimal cost and time delay risk, pursue collateral of the borrower while continuing its pursuit of the guarantor, it should make reasonable efforts to do so. Wherever possible, notice should be given, even if not required. When pursuing a guarantor prior to the foreclosure on any collateral, the lender should keep in mind that it is not entitled to a windfall. Common sense would suggest that adherence to commercially reasonable business practices is advisable.

See also annotation to Section 3.1(a)(v) (Certain Agreements and Additional Waivers by Guarantor), *supra*.

[91] *See* third annotation to Section 2.1 (Guaranty of Payment), *supra*; annotations to Section 2.5 (Waivers), *supra*; annotations to Section 3.1(a)(vi) (Certain Agreements and Additional Waivers by Guarantor), *supra*; and annotation to Section 3.1(a)(viii) (Certain Agreements and Additional Waivers by Guarantor), *supra*.

(xi) if for any reason Lender is required to refund any payment made by Borrower to any other Person liable for the payment or performance of any or all of the Guaranteed Obligations or pay the amount thereof to any other Person;

(xii) the making of advances by Lender to protect its interest in the Mortgaged Property, to preserve the value of the Mortgaged Property, or for the purpose of performing any term or covenant contained in any of the Loan Documents;[92]

(xiii) the existence of any claim, counterclaim, setoff or other right that Guarantor may at any time have against Borrower, Lender or any other Person, whether or not arising in connection with this Guaranty, the Note or any other Loan Document (provided, however, that nothing contained herein shall prevent the assertion of any such claim by separate suit or compulsory counterclaim);[93]

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[92] In this Section 3.1(a)(xii), Lender is obtaining Guarantor's agreement that actions taken by Lender to protect or enforce the security of Lender's collateral or to remedy the failure of Borrower to perform certain covenants and agreements made in the Loan Documents will not detrimentally affect Lender's rights under this Guaranty. In fact, any amounts expended by Lender for the cited purposes are included within the definition of "Guaranteed Indebtedness" as the Loan Documents, generally the Deed of Trust, usually (i) give Lender the right to disburse or advance any sums and take any actions as may be necessary or desirable to protect or enforce the security of the Deed of Trust or to remedy the failure of Borrower to perform its obligations, covenants and agreements contained in the Loan Documents, and (ii) provide that such amounts expended by Lender in exercising this right are due and payable by Borrower on demand. *See* clause (i) of the definition of "Guaranteed Indebtedness" in Section 1.1 (Definitions), *supra* (including all costs, expenses and sums of money now or hereafter owing, or for which Borrower is liable to pay under the Loan Documents).

Although increasing the amount of the Guaranteed Indebtedness initially appears to be adverse to Guarantor's interests, Guarantor's and Lender's interests are actually similar - Lender's actions to protect the security interest granted in the Deed of Trust, to preserve the value of the underlying collateral or to enable Borrower to meet its obligations and continue in business, also serve to limit Guarantor's potential liability under the Guaranty.

[93] Although this "catch-all waiver of claims" may be enforceable in most instances, certain causes of action, like fraud and negligence, may require more specificity in the waiver language to ensure the waiver is valid. Texas cases hold that the parties may contract away **fraudulent inducement** claims if the agreement to do so "clearly expresses the parties' intent to waive fraudulent inducement claims or disclaims reliance on representations about specific matters in dispute." Schlumberger Tech. Corp. v. Swanson, 959 S.W.2d 171, 181 (Tex. 1997). Such a waiver may also preclude a later claim of fraudulent nondisclosure. *See* SMB Partners Ltd. v. Osloub, 4 S.W.3d. 368, 371 (Tex. App.–Houston [1st Dist.] 1999, no pet.). In this context, the Schlumberger case is instructive. There the court upheld the waiver of fraudulent inducement where there was an express disclaimer concerning reliance upon representations by Schlumberger. Note, however, that the court in Schlumberger emphasized that a disclaimer of reliance, depending on the rules of contract interpretation, does not always bar a fraudulent inducement claim (citing Prudential Ins. Co. of Am. v. Jefferson Assoc., Ltd., 896 S.W.2d 156, 162 (Tex. 1995)). *See also* Italian Cowboy Partners, Ltd. v. Prudential Ins. Co. of Am., 341 S.W.3d 323, 336 (Tex. 2011) (refusing to extend its holding in Schulmberger to a lease where there was no clear, unequivocal and express disclaimer of reliance in a merger clause).

In order to ensure that a fraudulent claim is waived, this Guaranty, in Section 4.1(j) (Representations and Warranties of Guarantor), *infra*, contains language expressly waiving fraudulent inducement and further expresses that Guarantor is disclaiming reliance on any and all representations of Lender in waiving such a claim. Under the "express negligence doctrine" courts require waiver provisions to be conspicuous to effectively waive claims arising

(xiv) the fact that any collateral, security, security interest or lien contemplated or intended to be given, created or granted as security for the repayment of the Guaranteed Obligations, or any part thereof, shall not be properly perfected or created, or shall prove to be unenforceable or subordinate to any other security interest or lien; it being recognized and agreed by Guarantor that Guarantor is not entering into this Guaranty in reliance on, or in contemplation of the benefits of, the validity, enforceability, collectability or value of any of the collateral for the Guaranteed Obligations;

(xv) the invalidity, illegality or unenforceability of all or any part of the Guaranteed Obligations,[94] or any Loan Document or any other document or agreement executed in connection with the Guaranteed Obligations, for any reason whatsoever, including without limitation, the fact that (A) the Guaranteed Obligations, or any part thereof, exceed the amount permitted by Law, (B) the act of creating the Guaranteed Obligations, or any part thereof, is *ultra vires*,[95]

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out of a party's sole negligence. *See* Ethyl Corp. v. Daniel Constr. Co., 725 S.W.2d 705, 708 (Tex. 1987); Dresser Indus., Inc. v. Page Petroleum, Inc., 853 S.W.2d 505, 508 (Tex. 1993). *See also* third annotation to Section 2.2 (Guaranty of Performance), *supra*. Although there is no "express fraud doctrine" and very little case law addressing waiver of fraud, a cautious lender will also make sure waivers of fraud are as conspicuous as a negligence waiver. Accordingly, Section 4.1(j) is printed in bold, capitalized letters.

[94] *See* first annotation to this Section 3.1 (Certain Agreements and Additional Waivers by Guarantor), *supra*, annotation to Section 3.1(a)(xiii) (Certain Agreements and Additional Waivers by Guarantor), *supra*, and all annotations to this Section 3.1(a)(xv) (Certain Agreements and Additional Waivers by Guarantor), *infra*, regarding defenses that are personal to a borrower and thus unavailable to a guarantor.

Although there are a number of situations in which a guarantor remains liable even when the borrower is released (by assertion of a valid defense or otherwise), it appears that where the underlying note or agreement between the borrower and the lender is **void for illegality**, either in fact or declared so by terms of law read into it, the guaranty must fall with it. *See* Nat'l City Bank of St. Louis, Mo. v. Taylor, 293 S.W. 613, 618 (Tex. Civ. App—Texarkana 1927, no writ) (stating that a court should not enforce a guaranty upon a note or contract where the note or contract itself ought not to be enforced against anyone). *See, e.g.*, Savin Corp. v. Copy Distrib. Co., Inc., 716 S.W.2d 690, 692 (Tex. App—Corpus Christi 1986, no writ) (holding that the guarantor was not liable because the underlying contract violated Texas antitrust laws and was thus void); Mass. Bonding & Ins. Co. v. Gottlieb, 15 S.W.2d 1020 (Tex. Comm'n App. 1929, judgm't adopted) (court held that underlying contract for the sale of goods through a lottery system was void, and thus guarantor of payment under such contract was released from liability).

[95] This waiver is included in an attempt to defeat any claim by Guarantor that the underlying Loan and the Guaranteed Obligations were created by an ***ultra vires*** act of Borrower. Such a waiver, however, may not be required. Courts have found that a guarantor under an absolute, unconditional guaranty can remain liable even if the borrower's incurrence of the underlying debt was *ultra vires*. *See, e.g.*, Nat'l City Bank of St. Louis, Mo., 293 S.W. at 618.

This waiver is also included in an abundance of caution and is further intended to eliminate a defense that the Guaranty is an *ultra vires* act of Guarantor. In general, a defense of *ultra vires* is no longer available in Texas. *See* TEX BUS. ORGS CODE ANN. § 20.002 (West 2010) (stating that "(A) lack of capacity of a corporation shall never be made the basis of any claim or defense at law or in equity, and (B) no act of a corporation and no conveyance or transfer of real or personal property to or by a corporation shall be invalid by reason of the fact that such act, conveyance, or transfer was beyond the scope of the purpose or purposes of the corporation . . ."); TEX BUS. ORGS CODE ANN. § 20.002 (West 2010) (stating that lack of capacity shall never be the basis of any claim or defense by a non-profit corporation); Inter-Continental Corp. v. Moody, 411 S.W.2d 578, (Tex. Civ. App.–Houston 1966, writ

(C) the officers, representatives or other Persons executing the Note or the other Loan Documents, or otherwise creating the Guaranteed Obligations, acted in excess of their authority,[96] (D) the Guaranteed Obligations violate any Laws related to usury,[97] (E) Borrower has valid defenses, claims or offsets (whether at

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ref'd n.r.e.) (holding the defense of *ultra vires* is unavailing to [a] corporation even though the other party had actual notice of the want of authority, and that a corporation could not avoid liability on its theory of *ultra vires* because a lack of capacity of a corporation shall never be made the basis of any claim or defense at law or in equity); TEX BUS. ORGS CODE ANN. § 2.101 (West 2010) (establishing that partnerships have the same powers as an individual or corporation to do all things necessary and convenient to carry out its business and affairs).

[96] This waiver is included to eliminate a defense that the officers, representatives or other persons executing the Loan Documents or creating the Guaranteed Obligations acted outside the scope of their authority. In order for an officer to act, his or her power as an agent must be sought in a delegation of authority from the corporation, directly or through its board of directors, formally expressed or implied from a habit or custom of doing business. *See* Sabine Inv. Co. of Tex., Inc. v. Stratton, 549 S.W.2d 247 (Tex. Civ. App.–Beaumont, 1977, no writ). The general rule is that the officers and agents of a corporation only have the authority that has been conferred upon them by the corporation, and contracts or acts in excess of their authority will not bind the corporation in the absence of estoppel or ratification. *See* Green v. Hugo, 17 S.W.79 (Tex. 1891); Continental Oil Co. v. Baxter, 59 S.W.2d 463 (Tex. Civ. App.–Eastland 1933, no writ); *see also* annotation to Paragraph C. in the Recitals to this Guaranty, *supra* (discussing the apparent authority of officers and agents of a corporation). The long upheld rule is that the corporation is not bound by the acts of its agents not within the scope of their authority. *See* Sells Petroleum v. Victory Swabbing Co., 209 S.W.2d 199 (Tex. Civ. App.–Texarkana, 1948, no writ).

[97] Certain enumerated defenses are personal to a borrower and cannot be raised by a guarantor. Among those is the defense of **usury**, which is a personal privilege of a borrower and is not available as a defense to be asserted by certain other parties. *See* Bower v. Independence Bank, 735 S.W.2d 566 (Tex. App.–Dallas 1987), *upheld in* Allee v. Benser, 779 S.W.2d 61 (Tex. 1989); Universal Metals & Mach., Inc. v. Bohart, 539 S.W.2d 874, 878 (Tex. 1976). Sections 305.001 and 349.001 of the Texas Finance Code state that "[a] creditor who contracts for [a usurious rate . . .] is liable *to the obligor* . . ." (emphasis added) TEX. FIN. CODE ANN. § 305.001 (West 2010), TEX. FIN. CODE ANN. § 349.001 (West 2010). A guarantor is not the "obligor" under the underlying note because a guarantor has no obligation under the contract between the lender and the borrower to pay the underlying indebtedness, but rather only to satisfy its obligations under the guaranty. As such, a guarantor has no standing to assert any usury claim to which the borrower may be entitled. *See* Houston Sash & Door Co. v. Heaner, 577 S.W.2d 217, 222 (Tex. 1979); Micrea Inc. v. Eureka Life Ins. Co. of Am., 534 S.W.2d 348, 354 (Tex. Civ. App.—Fort Worth 1976, writ ref'd n.r.e.). The Court in Houston Sash & Door Co. stated that the rights afforded by the usury statute are restricted "to the immediate parties to the transaction," of which the guarantor is not one. *See* Houston Sash & Door Co., 577 S.W.2d at 222.

In Bank of El Paso v. T.O. Stanley Boot Co., 809 S.W.2d 279, 290 (Tex. App.–El Paso 1991), the court cited Alamo Lumber Co. v. Gold, 661 S.W.2d 926, 928 (Tex. 1983), for the proposition that usury is only available as a defense to those who "pay or assume" a third party debt. The Bank of El Paso court specifically held that a guarantor does not "pay or assume" the debt and is an obligor only under its guaranty, and is therefore not availed of the usury defense. *See id.* This is the case even when the guaranty was executed at the same time as the note and was within the actual contemplation of the parties at that time. *See* Sunbelt Savs., 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); Fourticq v. Fireman's Fund, Ins. Co., 679 S.W.2d 562, 564 (Tex. App.—Dallas, 1984, no writ).

It is also important to distinguish between a defense of usury arising under a promissory note that may be asserted by the borrower (but not by the guarantor) and a defense of usury arising directly under a guaranty that may be asserted by the guarantor. *See* annotation to Section 6.17 (Controlling Agreement), *infra*, for a discussion of this distinction. A guarantor may be able to assert its own usury defense with respect to the payment of interest by the guarantor on certain costs and expenses under the its guaranty. Accordingly, this Guaranty incorporates both (i) a law, in equity or by agreement) that render the Guaranteed Obligations wholly or partially uncollectible from Borrower,[98] (F) the creation, performance or repayment of the Guaranteed Obligations (or the execution, delivery and performance of any document or instrument representing part of the Guaranteed Obligations or executed in connection with the Guaranteed Obligations, or given to secure the repayment of the Guaranteed Obligations) is illegal, uncollectible or unenforceable, or (G) the Note or any of the other Loan Documents has been forged or otherwise is irregular or not genuine or authentic.[99] Guarantor hereby agrees that Guarantor shall remain liable hereon regardless of whether Borrower or any other Person is found not liable on the Guaranteed Obligations or any part thereof for any reason, and regardless of any joinder of Borrower or any other Person in any action to obtain payment or performance of any or all of the Guaranteed Obligations;[100] or

(xvi) any order, ruling or plan or reorganization emanating from proceedings under any Debtor Relief Law with respect to Borrower or any other

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waiver by Guarantor of the defense of usury with respect to the Guaranteed Obligations, and (ii) a "usury savings" provision under Section 6.17 (Controlling Agreement), *infra*, as prudent practice.

[98] *See* first annotation to this Section 3.1 (Certain Agreements and Additional Waivers by Guarantor), *supra*, and all annotations to this Section 3.1(a)(xv) (Certain Agreements and Additional Waivers by Guarantor), for a more detailed discussion of situations in which a borrower may have valid defenses which make the indebtedness uncollectible from the borrower, but which defenses would not affect the liability of a guarantor to pay such indebtedness.

[99] A payment guarantor is still liable even if the borrower's signature was **forged**. *See* Universal Metals & Mach., Inc., 539 S.W.2d at 877. *See also* first annotation to this Section 3.1 (Certain Agreements and Additional Waivers by Guarantor), *supra*, and last annotation to this Section 3.1(a)(xv), *infra*.

[100] Under a payment guaranty, a guarantor is liable as a co-maker under a note. *See* Hopkins v. First Nat'l Bank at Brownsville, 551 S.W.2d 343, 345 (Tex. 1977). Consequently, circumstances may arise where a guarantor is liable for a debt even though the debt is unenforceable against the borrower. **Usury**: Even if the borrower is able to successfully assert a usury defense, a guarantor will remain liable for the obligations imposed under its guaranty. S*ee* annotation to clause (D) in this Section 3.1(a)(xv) (Certain Agreements and Additional Waivers by Guarantor), *supra*, and annotation to Section 6.17 (Controlling Agreement), *infra.* **Forgery**: A payment guarantor is still liable even if the borrower's signature was forged. *See* annotation to clause (G) in this Section 3.1(a)(xv) (Certain Agreements and Additional Waivers by Guarantor), *supra.* **Non-recourse**: The fact that a debt is non-recourse as to the borrower does not change the fact that the borrower has incurred debt, and although the borrower cannot be held liable for the debt, there is still indebtedness for which the guarantor is liable. *See* RTC v. Northpark Joint Venture, 958 F.2d 1313 1320 (5th Cir. 1992). Where a guaranty is a continuing guaranty which includes renewals and extensions, the guarantor is not relieved from liability even if the nature of the loan is changed from recourse to non-recourse. *See* Travelers Ins. Co. v. Bosler, 906 S.W.2d 635, 642-43 (Tex. App.–Fort Worth 1995, writ denied), *vacated by agreement on motion for rehearing*, 938 S.W.2d 716 (Tex. 1997); *see also* annotation to Section 3.1(a)(i) (Certain Agreements and Additional Waivers by Guarantor), *supra*. **Statute of Limitations***:* Further, a guarantor cannot assert the borrower's statute of limitations defense to defeat a claim against the guarantor. *See* annotation to Section 3.1(a)(iii) (Certain Agreements and Additional Waivers by Guarantor), *supra*.

See also first annotation to Section 3.1 (Certain Agreements and Additional Waivers by Guarantor), *supra*.

Person, including any extension, reduction, composition, or other alteration of the Guaranteed Obligations, whether or not consented to by Lender.[101]

(b) If any payment by Borrower or any other Person to Lender is held to constitute a preference, fraudulent transfer or other voidable payment under any Debtor Relief Law, or if for any other reason Lender is required to refund such payment or pay the amount thereof to any other Person, then such payment by Borrower or any other Person to Lender shall not constitute a release of Guarantor from any liability hereunder, and this Guaranty shall continue to be effective or shall be revived and reinstated[102] (notwithstanding any prior release, surrender or discharge by Lender of this Guaranty or of Guarantor), as the case may be, with respect to, and this Guaranty shall apply to, any and all amounts so refunded by Lender or paid by Lender to another Person (which amounts shall constitute part of the Guaranteed Obligations), and any interest paid by Lender and any attorneys' fees, costs and expenses paid or incurred by Lender in connection with any such event.[103] It is the intent of Guarantor and Lender that the obligations and liabilities of Guarantor hereunder are absolute, unconditional and irrevocable under any and all circumstances and that until the Guaranteed Obligations are fully and finally paid and performed, and not subject to refund or disgorgement, the obligations and liabilities of Guarantor hereunder shall not be discharged or released, in whole or in part, by any act or occurrence that might, but for the provisions of this Guaranty, be deemed a legal or equitable discharge or release of a guarantor.[104] Lender

[101] *See* annotation to Section 3.1(a)(vii) (Certain Agreements and Additional Waivers by Guarantor), su*pra*.

[102] As this provision relates to preferences, fraudulent transfers and other "avoidable" transfers under any Debtor Relief Law, the enforceability and validity of this provision is well established. Courts have uniformly held that a payment upon a debt that is later set aside as avoidable under the Bankruptcy Code will not discharge a guarantor of its obligations to repay that debt. *See* In re Coutee, 984 F.2d 138, 141-42 (5th Cir. 1993); Wallace Hardware Co., Inc. v. Abrams, 223 F.3d 382, 408 (6th Cir. 2000); Lowrey v. Mfr. Hanover Leasing Corp. (In re Robinson Bros. Drilling, Inc.), 6 F.3d 701, 704 (10th Cir. 1993); Crocker v. Third Nat'l Bank (In re Quality Takes Time, Inc.), 96 B.R. 818, 819-20 (Bankr. M.D. Tenn.1989); Schwarz v. Equitable Bank, N.A. (In re Express Liquors, Inc.), 65 B.R. 952, 962 (Bankr. D. Md. 1986); Neill v. Borreson (In re John Peterson Motors, Inc.), 56 B.R. 588, 596 & n.10 (Bankr. D. Minn. 1986); Herman Cantor Corp. v. Cent. Fidelity Bank, N.A. (In re Herman Cantor Corp.), 15 B.R. 747, 750 (Bankr. E.D. Va. 1981).

[103] *See* second annotation to definition of "Guaranteed Indebtedness" in Section 1.1 (Definitions), *supra*.

[104] As previously discussed in the annotation to Section 3.1(a)(vii), *supra*, the discharge of the debtor generally does not affect the liabilities of a nondebtor. An additional concern for a lender might be the equitable subordination of its claim against the debtor under section 510 of the Bankruptcy Code. Section 510(c) permits the Court to subordinate claims under principles of equitable subordination. *See* 11 U.S.C. § 510(c) (2009). As developed by the bankruptcy courts, equitable subordination generally requires some type of misconduct by the holder of a claim. Equitable subordination is a remedial, not penal measure. *See* In re U.S. Abatement Corp., 39 F.3d 556, 561 (5th Cir. 1994). Before a claim will be equitably subordinated, three conditions must be met: (1) the claimant must have engaged in some type of inequitable conduct; (2) the misconduct must have resulted in injury to the creditors or conferred an unfair advantage on the claimant; and (3) equitable subordination must not be inconsistent with the provisions of the Bankruptcy Act. *See id*. *See also* Benjamin v. Diamond. (In re Mobile Steel Co.), 563 F.2d 692 (5th Cir. 1977). As a general rule, the equitable subordination of a lender's claim in bankruptcy

shall be entitled to continue to hold this Guaranty in its possession for the longer of (i) the period after which any performance of obligations under any Loan Document **[including, without limitation, under the Loan Agreement or the Environmental Indemnity Agreement]** shall accrue, or (ii) a period of 367 days from the date the Guaranteed Obligations are paid and performed in full and for so long thereafter as may be necessary to enforce any obligation of Guarantor hereunder or to exercise any right or remedy of Lender hereunder. Lender's surrender of this Guaranty shall not impair the revival, reinstatement and survival provisions set forth in this Section 3.1 or elsewhere in this Guaranty.

(c) If acceleration of the time for payment of any amount payable by Borrower under the Note or any other Loan Document is stayed or delayed by any Law or Tribunal, all such amounts shall nonetheless be payable by Guarantor on demand by Lender.

3.2 Guaranteed Obligations Not Reduced by Offset. The Guaranteed Obligations and the liabilities and obligations of Guarantor to Lender hereunder, shall not be reduced, discharged or released because or by reason of any existing or future offset, claim or defense of Borrower, or any other party, against Lender or against payment of the Guaranteed Obligations, whether such offset, claim or defense arises in connection with the Guaranteed Obligations (or the transactions creating the Guaranteed Obligations) or otherwise. Without limiting the foregoing or Guarantor's liability hereunder, to the extent that Lender advances funds or extends credit to Borrower, and does not receive payments or benefits thereon in the amounts and at the times required or provided by applicable agreements or Laws, Guarantor is absolutely liable to make such payments to (or confer such benefits on) Lender, on a timely basis.[105]

ARTICLE IV
REPRESENTATIONS, WARRANTIES AND COVENANTS

4.1 Representations and Warranties of Guarantor. Guarantor hereby represents and warrants to Lender that:

(a) (i) Guarantor is the owner of a direct or indirect interest in Borrower **[and is an Affiliate/officer/partner/member/shareholder of Borrower]**, (ii) the value of the consideration and benefit received and to be received by Guarantor, directly or indirectly,

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does not affect the lender's ability to recover from a nondebtor third party. *See* 11 U.S.C. § 510(c) (2009); Long Island Lighting Co. v. Bokum Res. Corp., 40 B.R. 274, 296 (Bankr. D.N.M. 1983).

[105] The failure of the lender to enforce the underlying obligation before it pursues the guaranty will not discharge the guarantor except as provided by statute, agreement of the parties, or if the pursuit of the underlying obligation is made a condition to the guarantor's liability. *See* Hopkins, 551 S.W.2d at 345; Ford v. Darwin, 767 S.W.2d 851, 854 (Tex. App.—Dallas 1989, writ denied). Be aware, however, that Section 43.002 of the Texas Civil Practice and Remedies Code allows a guarantor to demand that the lender take action against the principal before pursuing the guarantor and if the lender does not do so, the guarantor is relieved of its obligation. This statute, however, does not apply to payment guarantors. *See* first and fourth annotations to Section 2.1 (Guaranty of Payment), *supra*, and last annotation to Section 2.3(a) (Primary Liability of Guarantor), *supra*.

as a result of Lender making the Loan to Borrower, and Guarantor executing and delivering this Guaranty, is reasonably worth at least as much as the liability and obligation of Guarantor hereunder, and (iii) the Loan has benefited and may reasonably be expected to benefit Guarantor, directly or indirectly;[106]

(b) this Guaranty is duly authorized and valid, and is binding upon and enforceable against Guarantor;[107]

(c) Guarantor is not, and the execution, delivery and performance by Guarantor of this Guaranty will not cause Guarantor to be, in violation of any Law or in

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[106] *See* annotation to Paragraph C. in the Recitals to this Guaranty, *supra*.

[107] The underlying premise for this clause (b) is to estop Guarantor from contesting the validity of the Guaranty or its covenants, and to further prevent either Guarantor or its counsel from "laying behind the log" as to issues which should be specifically addressed and encompassed herein. The determination as to whether the Guaranty is enforceable is ultimately the responsibility of Lender's counsel but should also be addressed in Guarantor's counsel's legal opinion. However, Lender is entitled to know if Guarantor has any reason, whether factual or legal, to believe that the Guaranty is not enforceable. In this context, "enforceable" means that the Guaranty is performable as drafted. This representation, together with the enforceability opinion of Guarantor's counsel, is an important part of Lender's due diligence in considering the funding of the Loan. **Execution by Specific Representatives*;*** **Execution by agent**: The authority of a an officer, manager, partner or other agent or representative of a guarantor to execute a guaranty on such guarantor's behalf should be in writing and expressly specific as to the scope of such signatory's authority. Lenders generally prefer not to accept documents that have been executed by a signatory pursuant to a power of attorney. If absolutely necessary, the following requirements must be met for execution by such agent to successfully bind the principal: (i) an original copy of a written power of attorney executed in recordable form, (ii) the written power of attorney must properly and specifically describe the loan transaction, and (iii) proof that the party executing the power of attorney is alive at the time the party holding the power executes the guaranty. **Execution by partner**: A lender should require the general partner to certify copies of the limited partnership agreement and should examine both the partnership agreement and a state-certified copy of the Certificate of Limited Partnership of the guarantor (if the guarantor is a limited partnership) to determine the signatory's authority. If the general partner is not specifically authorized to act on behalf of the limited partnership under the terms of the partnership agreement, it may be prudent to require that an original consent of partners be delivered at closing which consent should clearly describe and authorize the transaction and certify that the partnership has not been dissolved (although if the guarantor has numerous limited partners, the guarantor is likely to resist this practice). **Execution by corporate (or company) officer**: A lender should examine a state-certified copy of the articles of incorporation (or organization) of the guarantor and an officer-certified copy of the bylaws (or operating agreement) to determine the signatory's authority and require that a certified copy of the borrowing resolutions be delivered at closing. These certificates should (i) list the officers, (ii) attach the bylaws, articles, state certificates, resolutions authorizing the guaranty, and be in "round robin" form (*i.e.*, secretary certifies as to officers, and another officer certifies that the individual signing as secretary is the secretary). *See* TEX. BUS. ORGS. CODE ANN. § 10.253 (West 2010). *See generally* James Noble Johnson, Execution of Documents, 29th ANNUAL MORTGAGE LENDING INSTITUTE (1995).

Although beyond the scope of this annotation, it should be noted that a signatory not having express authority to sign a guaranty may still possess "apparent authority" to bind the guarantor. *See also* second annotation on the Signature Page of this Guaranty, *infra*, and second annotation to Section 4.1(d) (Representations and Warranties of Guarantor), *infra*.

See also annotations to Paragraph C. in the Recitals to this Guaranty, *supra*, and clauses (B) and (C) in Section 3.1(a)(xv) (Certain Agreements and Additional Waivers by Guarantor), *supra*.

breach of or in default (or at risk of acceleration of indebtedness) under any contract, agreement or restriction by which Guarantor is bound or affected;

(d) **[For any entity other than an individual**: Guarantor is duly organized, validly existing, and in good standing under the Laws of the state of its organization **[and under Texas Laws] [*for an entity organized in a state other than Texas*: and is lawfully doing business in Texas,]**[108] and has full power and authority to enter into and perform this Guaranty**]**;[109]

[108] A determination of whether Guarantor is "lawfully doing business in Texas" will require, among other things, a close examination as to whether Guarantor must be licensed to do business in Texas by virtue of Guarantor's other activities in Texas in addition to the making of the Guaranty. The mere making of the Guaranty will not by itself (i) constitute doing business in Texas or (ii) require registration by or licensing of Guarantor as a foreign corporation in Texas. *See* TEX. BUS. ORGS. CODE ANN. §9.251 (West 2010). The Texas Limited Liability Company Act and Texas Business Corporation Act address the admission of foreign limited liability companies and business corporations, respectively, and the requirements to obtain a certificate of authority (evidence of qualification to do business) from the Secretary of State of the State of Texas. Under the foregoing statutes there are certain activities by which a foreign company or corporation "shall not be considered to be transacting business in this State, for purposes of this Act, by reason of carrying on in this State any one (1) or more of the following activities: . . . (7) Creating as borrower or lender, or acquiring, indebtedness or mortgages or other security interests in real or personal property; (8) Securing or collecting debts due to it or enforcing any rights in property securing the same." *See* TEX. BUS. ORGS. CODE ANN. §9.251 (West 2010).

Further analysis of whether a Guarantor is "lawfully doing business in Texas" will include an examination of (i) appropriate governmental certificates for Guarantor and any entity that is acting on behalf of Guarantor (*e.g.*, a general partner), (ii) if Guarantor is created under the laws of another state, certificates of authority from the Secretary of State, and (iii) as appropriate, an assumed name certificate. Ideally, these governmental certificates should be dated as of the date of the Guaranty.

The failure of a foreign corporation to obtain a certificate of authority to transact business in the State of Texas, however, does not impair the validity of any contract, but rather will subject such corporation to fines and penalties and will prevent such corporation from maintaining an action, suit or proceeding in Texas . *See* TEX. BUS. ORGS. CODE ANN. § 9.051 (West 2010). Thus, for a guaranty to be valid and enforceable, it is not required that the guarantor be "lawfully doing business in Texas."

[109] By statute, any corporation doing business in Texas has the power and authority to make a guaranty if the guaranty reasonably may be expected to directly or indirectly benefit the guarantor corporation. *See* TEX. BUS. ORGS CODE ANN. § 2.104 (West 2010). *See also* annotation to Paragraph C. in the Recitals, *supra*. This statute provides broad authority to a corporation so as long as the guaranty benefits the corporation. Counsel would be prudent to include a statement in the authorizing resolutions that the Guaranty does benefit Guarantor so as to address the one exception stated in the preceding statute. However, a board decision is not a statutory prerequisite before an enforceable guaranty can be made. *See* Ginsberg 1985 Real Estate P'ship v. Cadle Co., 39 F.3d 528, 535 (5th Cir. 1994). Whether a person had full power and authority to execute a guaranty will not be determinative of the guaranty's validity and enforceability, because under Texas law, acts of a corporation's officers and agents can create a valid guaranty binding on the corporation through the exercise of apparent authority. *See id*. The inclusion of a representation and warranty that the guarantor has the "full power and authority" to enter into and perform the guaranty will be preferable to a lender because it is a further indication of apparent authority and it provides an enforcement mechanism in that the lender can sue to enforce its remedies under the guaranty in the event of a breach. *See also* the second annotation on the Signature Page of this Guaranty, *infra*, and annotation to Section 4.1(b) (Representations and Warranties of Guarantor), *supra*.

(e) there is no Litigation pending or, to the knowledge of Guarantor, threatened, before or by any Tribunal against or affecting Guarantor;

(f) all financial statements and information heretofore furnished to Lender by Guarantor do, and all financial statements and information hereafter furnished to Lender by Guarantor will, fully and accurately present the condition (financial or otherwise) of Guarantor as of their dates and the results of Guarantor's operations for the periods therein specified, and, since the date of the most recent financial statements of Guarantor heretofore furnished to Lender, no Material Adverse Change has occurred in the financial condition of Guarantor, nor, except as heretofore disclosed in writing to Lender, has Guarantor incurred any material liability, direct or indirect, fixed or contingent;

(g) no bankruptcy or insolvency proceedings are pending or contemplated by or against Guarantor,[110] and, after giving effect to this Guaranty, Guarantor is solvent, is not engaged or about to engage in business or a transaction for which the property of Guarantor is an unreasonably small capital, and has not incurred and will not incur debts that will be beyond Guarantor's ability to pay as such debts mature;[111]

[110] The Guaranty should contain a representation from Guarantor that no bankruptcy or insolvency proceedings are pending or contemplated by or against Guarantor, and the Deed of Trust or Loan Agreement should contain a representation from Borrower that no bankruptcy or insolvency proceedings are pending or contemplated by or against Borrower or against any other guarantor or endorser of the Note. *See* Annotated Deed of Trust, Section 3.13 (No Bankruptcy). The practical result of this representation could be substantial, if false. Section 523 of the Bankruptcy Code excepts from an individual debtor's (but not an entity debtor's) discharge any debt for an extension, renewal, or refinancing of credit, to the extent obtained by "false pretenses, a false representation, or actual fraud." *See* 11 U.S.C. § 523(a)(2) (2009). The suggested representation, if false when made (assuming the other elements of fraud are established), could persuade a bankruptcy judge to hold the debt to be non-dischargeable. Obviously, with the passage of time between the extension of credit and a subsequent bankruptcy filing, it becomes increasingly difficult to establish fraudulent intent. It should be noted that a creditor may be able to determine before the extension of credit whether the proposed borrower or guarantor is in bankruptcy. Bankruptcy papers are public records (*See* 11 U.S.C. § 107 (2009)) and are generally available online through each Court's computerized records system, called PACER (see www.Pacer.gov for more information). A variety of third-party credit reporting services also monitor bankruptcy filings for a fee. However, Bankruptcy Courts have been liberal in allowing debtors to file in various jurisdictions, including a district in which one of the debtor's properties is located; therefore, it is difficult to be absolutely sure the borrower or the guarantor has not filed a bankruptcy proceeding and multiple jurisdictions may need to be checked. Additionally, the filing of a bankruptcy petition operates as a "stay" and prevents a creditor/lender from taking certain actions, including: (i) the commencement or continuation of a judicial or administrative action against the debtor in bankruptcy, (ii) enforcement of any judgment against the debtor, (iii) any act to obtain possession or exercise control over property of the debtor, or (iv) any act to create, perfect or enforce any lien against property or collateral of the debtor. *See* 11 U.S.C. § 362 (2009).

[111] This representation is intended to eliminate an assertion of a defense that Lender knew that Guarantor was insolvent at the time that it entered into the transaction. Cases concerning a guarantor's insolvency have drawn a fine line in determining whether a creditor has "reasonable cause to believe" that a debtor is insolvent. For reasonable cause to exist, it is not necessary that a person who benefited by a transfer know positively that the result of the transaction will be in effect a preference. It is sufficient for a finding of reasonable cause that the person or his agent had knowledge of such facts that would induce a person of reasonable prudence to make inquiry when such inquiry would have developed the facts essential to the situation. *See* Clower v. First State Bank of San Diego, Tex., 343 F.2d 808, 810 (5th Cir. 1965). However, if the facts known to the creditor should raise only a suspicion that the debtor might be insolvent, the test is not met. *See id*. In Clower, the court imposed an affirmative duty of reasonableness on a creditor to ask questions that would obviate potential insolvency. *See id.* at 812 (suggesting that

(h) Guarantor is familiar with, and has independently reviewed books and records regarding, the financial condition of Borrower and is familiar with the value of any and all collateral intended to be created as security for the payment of the Note or the Guaranteed Obligations; but, Guarantor is not relying on such financial condition or the collateral as an inducement to enter into this Guaranty;

(i) Guarantor has read and fully understands the provisions contained in this Guaranty, the Note, the Deed of Trust and the other Loan Documents;

(j) ***NEITHER LENDER, BORROWER NOR ANY AFFILIATE OF EITHER LENDER OR BORROWER HAS MADE ANY REPRESENTATION, WARRANTY OR STATEMENT TO GUARANTOR IN ORDER TO INDUCE GUARANTOR TO EXECUTE THIS GUARANTY, AND GUARANTOR HEREBY EXPRESSLY WAIVES ANY CLAIM OF FRAUDULENT INDUCEMENT TO EXECUTE THIS GUARANTY AND FURTHER DISCLAIMS ANY RELIANCE ON STATEMENTS OR REPRESENTATIONS OF LENDER IN WAIVING SUCH A CLAIM;***[112] and

(k) Guarantor has, independently and without reliance upon Lender, and based upon such documents and information as Guarantor has deemed appropriate, made its own analysis and decision to enter into this Guaranty.

there were signs which, to a reasonably prudent creditor, pointed unerringly to insolvency and that few inquiries would have disclosed such insolvency). For further discussion, *compare* Marks v. Goodyear Rubber Sundries, Inc., 238 F.2d 533 (2d Cir. 1956) *with* Lang v. First Nat'l Bank of Houston, 215 F.2d 118 (5th Cir. 1954) (discussing what facts would be sufficient to put a reasonable person on notice that additional inquiries should be made regarding a debtor's insolvency). In preference cases, courts look for notice of circumstances that would incite a person of ordinary prudence to an inquiry notice of all facts which a reasonably diligent inquiry would have disclosed. *See* Pender v. Chatham Phenix Nat'l Bank and Trust Co., 58 F.2d 968, 969 (2d Cir. 1932).

[112] Since a claim of **fraudulent inducement** is one based upon particular facts and circumstances, this representation is intended to provide evidence that Guarantor has not relied on any representation, warranty or statement by Lender in order to enter into the Guaranty. The elements of a claim of fraudulent inducement are (1) a material misrepresentation, (2) which was false, (3) which was known to be false when made or was made recklessly as a positive assertion without knowledge of its truth, (4) which was intended to be acted upon, (5) which was relied upon, and (6) which caused injury. *See* Insurance Co. of N. Am. v. Morris, 981 S.W.2d 667, 674 (Tex. 1998). In Rucker v. Bank One Tex., N.A., 36 S.W. 3d 649 (Tex. App.–Waco, 2000, no pet.), two guarantors asserted a counterclaim and affirmative defenses of fraudulent inducement. After finding that the facts necessary to prevail on the counterclaim were identical to those necessary to defend against the primary suit on the defense of fraudulent inducement and breach of contract, the Rucker court remanded the case. *See* annotation to Section 3.1(a)(xiii) (Certain Agreements and Additional Waivers by Guarantor), *supra*, for further discussion of the reasons for this representation, and why this language includes a waiver provision and is in bold, capitalized letters.

4.2 Financial Statements[113] and Reporting Requirements. Guarantor covenants and agrees that, so long as the Guaranteed Obligations or any part thereof is outstanding and not paid, performed or satisfied in full, or Lender has any commitment to Borrower, Guarantor shall:

(a) furnish or cause to be furnished to Lender the following:

(i) within ________________________ (____) days after the end of each **[fiscal quarter/year of Guarantor] [calendar quarter/year]**, financial statements, which shall mean and include a balance sheet, a statement of cash flow and an income statement, such reports to be in such form and in such reasonable detail as Lender may request, setting forth the financial condition (including all contingent liabilities), cash flow and the income and expenses for Guarantor for the immediately preceding **[fiscal quarter/year of Guarantor] [calendar quarter/year]**, prepared in accordance with **[the cash basis of accounting, applied on a consistent basis that fairly presents the results of operations for the period covered thereby] [accepted accounting principles] [GAAP]** consistently applied, and which fairly present the financial condition and transactions of Guarantor as of the date thereof or for the period covered thereby, and, if Guarantor is an individual, certified to be true, correct and complete by Guarantor, or if Guarantor is an entity, audited and certified to by an independent certified public accountant for the **[fiscal] [calendar]** year financial statements;

(ii) **[within 15 days after the filing of same] [as soon as available, but in no event later than ___________________ (____) days after the end of each fiscal year of Guarantor]**, a tax return for each fiscal year of Guarantor from and after the date hereof; **[provided, however, if Guarantor shall have duly filed for an extension of the deadline for such tax return in accordance with all applicable requirements of the Tax Code, and promptly furnishes evidence thereof to Lender, then such tax return shall be delivered to Lender on or before 255 days after the end of such fiscal year]**;[114]

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[113] Financial statements received during the underwriting stages of the loan provide a lender with information necessary to make credit decisions with respect to the guarantor's ability to repay the loan. On an ongoing basis, financial statements help the lender monitor the transaction and the Guarantor's financial viability and performance, and further provide an early warning system of a potential Default. Thus, required financial statements should provide sufficient information about resources that can generate cash, obligations to other parties that might diminish that ability to generate cash, and other significant events affecting the business or financial condition of Guarantor. Although the financial statements required in a real estate-secured loan often differ from those found in loans to operating companies, the basic premise is the same: this information is valuable and the types of information provided must be tailored to the particular transaction to be meaningful. A good discussion of financial statements in the context of credit facilities can be found in Stern, Structuring and Drafting Commercial Loan Agreements, Revised Edition, Vol. 1, A.S. Pratt & Sons (2000).

[114] Just as financial statements are important, much useful information can be obtained from tax returns. In fact, in the case of individual guarantors who do not prepare GAAP statements and are not ordinarily as comfortable preparing detailed personal financial statements (including cash flow statements), the information found in their tax returns can be an invaluable source of information that is material to the lender.

(iii) on or before ____________ (___) days after the end of each **[fiscal quarter/year of Guarantor] [calendar quarter/year]**, a certificate (in form acceptable to Lender) by Guarantor certifying that, as of the date thereof, **[(A)]** there does or does not (as the case may be) exist (1) an event which constitutes, or which upon due notice or lapse of time or both would constitute, a Default or, if such Default exists, specifying the nature thereof, and (2) any Material Adverse Change (provided, however, that Guarantor shall provide immediate written notice to Lender of the occurrence of any Default or Material Adverse Change)**[,] [; and]**[115] **[and (B) that Guarantor is in compliance with all of the financial covenants set forth in <u>Section 4.3</u> hereof, which certificate shall also include a statement as to Guarantor's Liquidity / Net Worth as of the date of such certificate, and Guarantor shall simultaneously therewith provide, in addition to the financial statements in accordance with the foregoing, all other financial information Lender may require to confirm the accuracy of such certificate; and]**

(iv) promptly after Lender's request, such additional information or financial statements concerning Guarantor as Lender may request from time to time.

All balance sheets and operating statements together shall include disclosure of all contingent liabilities, **[a profit and loss statement, an income and expense statement, a reconciliation of capital and surplus, and a schedule of sources and uses of funds, a detailed cash flow statement]** and changes in financial condition for the applicable period, together with such supporting schedules and documentation as Lender may require. **[A detailed cash flow statement for each project in which the reporting Person has an interest shall include (i) the project name and location, (ii) percentage of ownership interest, (iii) leasing status, (iv) net operating income, (v) current loan balance, (vi) debt service, (vii) source of any operating deficit, (viii) amount of and beneficiary of any cash distributions, and (ix) the amount of cash invested in or received from such project. All operating statements for a period also shall include a comparison to the budget for such period and an explanation of any variances from such budget.]** All balance sheets and operating statements shall be certified by Guarantor **[and the balance sheet and operating statement described in <u>clause (a)(i)</u> above shall be audited by independent certified public accountants of recognized**

[115] Loan documents generally include a requirement that the borrower and guarantor alert the lender immediately when a Default occurs. Likewise, a requirement of immediate notice to the lender of any Material Adverse Change is an important additional item of due diligence that will provide the lender with an early warning about a change in Borrower's or Guarantor's financial stability. Such notifications should occur as soon as possible so that the parties can decide upon an appropriate course of action. In many cases the Default can be addressed by prompt action or by agreement between the parties. This provision is part of an early warning system for potential problems and is important irrespective of what consequences may arise as a result of such Default or Material Adverse Change.

standing, selected by Guarantor, and consented to by Lender without qualification or exception other than those acceptable to Lender];[116] and

(b) (i) obtain at any time and from time to time all authorizations, licenses, consents or approvals as shall now or hereafter be necessary or desirable under all applicable Laws or otherwise in connection with the execution, delivery, and performance of this Guaranty and will promptly furnish copies thereof to Lender; and (ii) at all times own, directly or indirectly, and free and clear of all liens and encumbrances whatsoever, at least the same percentage of voting shares or the same percentage of partnership interest or limited liability company membership of Borrower, if any, as it owns directly or indirectly on the date hereof.[117]

4.3 Financial Covenants.

[*See Rider 3 for Specific Financial Covenants.*]

4.4 Waiver of Subrogation Rights.[118] Guarantor hereby covenants and agrees that, until the Guaranteed Obligations have been paid, performed and satisfied in full, it shall not

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[116] *See* first annotation to this Section 4.2 (Financial Statements and Reporting Requirements), *supra*.

[117] Like other covenants, the main purpose of this covenant is to set forth guidelines to ensure that Guarantor conducts business in a manner that will not adversely affect Lender or Guarantor's creditworthiness. The only rights the lender has are set out in the loan documents; thus a lender ordinarily seeks to protect its investment by establishing such guidelines. There are generally fewer covenants in real estate-secured transactions than in general commercial loans, but some basic provisions such as those found in clause (i) of Section 4.2(b) are important. In addition, this Section 4.2(b) restricts the transfer of ownership interests by Guarantor in Borrower because a lender's decision to enter a loan transaction is often based partly upon the business reputation of the principals.

Information a lender requires from a particular borrower or guarantor depends upon the amount and type of the loan, the creditworthiness, the type of business participated in, whether the parties are public or private companies, and other similar factors. In particular circumstances, additional reporting requirements may be necessary. For example, if receivables and inventory are a substantial part of the collateral, then detailed agings and information about inventory turnover will be important. Likewise, if a borrower is a retailer or a distributor, confirmation that sales and fuel taxes have been paid is essential since governmental authorities often assert trust fund theories for unpaid taxes.

Information not included in the financial statements that would ordinarily affect or reflect finances and financial positions include pro forma statements, projections, plans and the like. These types of information can often be important in monitoring the loan and in establishing an early warning system to avert potential problems.

[118] The doctrine of subrogation provides that a guarantor who pays the debt of an obligor stands in the place of the creditor with all the creditor's rights for the purpose of obtaining reimbursement from the obligor. *See* Pearlman v. Reliance Ins. Co., 371 U.S. 132, 137 (1962) (the doctrine of subrogation is "deeply imbedded in our commercial practices, our economy, and our law"); San Antonio Cattle Loan Co. v. Blalack & Son, 256 S.W. 974, 975 (Tex. Civ. App.–San Antonio 1923), *aff'd in part and rev'd in part on other grounds* 267 S.W.2d 474 (Tex. Comm'n App. 1925); McBroome-Bennett Plumbing Co. v. Villa France, Inc., 515 S.W.2d 32, 36 (Tex. Civ. App.–Dallas 1974, writ ref'd n.r.e.); Cockrell v. Republic Mortgage Ins. Co., 817 S.W.2d 106, 113 (Tex. App.–Dallas 1991, no writ); Lancer Corp. v. Murillo, 909 S.W.2d 122 (Tex. App.–San Antonio 1995, no writ). Subrogation enables the person being substituted to succeed to the rights of the other party. *See* McBroome-Bennett, 515 S.W.2d

assert, enforce or otherwise exercise or be entitled to, and hereby waives, (i) any right of subrogation to any of the rights or liens of Lender or any other Person against Borrower or any other guarantor of the Guaranteed Obligations or any collateral or other security, or any right of subrogation in or under any of the Loan Documents or to participate in any way therein, or in any right, title or interest in or to any security for the Guaranteed Obligations, or (ii) unless such rights are expressly made subordinate (in form and substance and upon terms acceptable to Lender in its sole and absolute discretion) to the Guaranteed Obligations and the rights of Lender under this Guaranty and the Loan Documents, any right of recourse, reimbursement, exoneration, contribution, indemnification, or similar right against Borrower or any other guarantor of or for all or any part of the Guaranteed Obligations.

4.5 Additional Covenants of Guarantor. Guarantor hereby further covenants to Lender that:

(a) Guarantor will keep itself fully apprised of Borrower's financial and business condition, and Guarantor shall be responsible for obtaining for itself information regarding Borrower including, without limitation, any changes in the financial or business condition of Borrower, and Guarantor acknowledges and agrees that Lender shall have no duty at any time to notify Guarantor of any information which Lender may

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at 36; Fleetwood v. Med. Ctr. Bank, 786 S.W.2d 550, 553 (Tex. App.–Austin 1990, writ denied); Hartford Cas. Ins. Co. v. Albertsons Grocery Stores, 931 S.W.2d 729, 733 (Tex. App.–Fort Worth 1996, no writ). Texas courts have applied the doctrine of subrogation to the context of suretyship, holding that when a surety pays the debt of a principal, the surety is subrogated to all of the rights, remedies, equities, and securities of the creditor. *See* Crimmins v. Lowery, 691 S.W.2d 582, 585 (Tex. 1985). Additionally, the doctrine of subrogation is always given a liberal interpretation in Texas. *See* Blalack, 256 S.W. at 976 ("doctrine of subrogation has not been carried to a greater or more comprehensive extent than in the decisions of the state of Texas"); Forney v. Jorrie, 511 S.W.2d 379, 386 (Tex. Civ. App.–San Antonio 1974, writ ref'd n.r.e.) ("doctrine of subrogation given a liberal application"); McBroome-Bennett, 515 S.W.2d at 36 ("Texas courts have always been particularly hospitable to the right of subrogation and have been in the forefront of upholding it"); Fleetwood, 786 S.W.2d at 554 ("[s]ubrogation has been recognized as an important doctrine and has traditionally received favorable treatment in Texas"); Matagorda Co. v. Tex. Ass. of Counties Co. Gov't Risk Mgmt. Pool, 975 S.W.2d 782, 785 (Tex. App.–Corpus Christi 1998, no pet.) ("equitable subrogation given a liberal application").

Like other surety defenses, however, the right of equitable subrogation can be waived. *See* Lancer Corp. v. Murillo, 909 S.W.2d at 127. Furthermore, "[t]here is no requirement of specificity with respect to the language used to forego discharge. General language indicating that the [surety/guarantor] waives defenses based on suretyship is sufficient. The [surety/guarantor] need not waive separately each ground for discharge, nor must the contract describe them." RESTATEMENT (THIRD) OF SURETYSHIP AND GUARANTY § 48, cmt d. (1996). The waiver of the right of equitable subrogation is important to a lender. A lender does not want the guarantor to pursue the borrower for the recovery of payments made by the guarantor to the lender under the guaranty until the underlying loan has been repaid in full. Otherwise the lender and the guarantor may have competing claims against the borrower, and if the guarantor successfully exercises its subrogation rights against the borrower, lender may, as a consequence, be faced with an insolvent borrower unable to repay the loan.

Some practitioners may include language commonly referred to as a Deprizio waiver, but such a waiver is unnecessary because in 2005, Congress provided a complete elimination of what it calls "the Deprizio problem" through its amendment of section 547 of the Bankruptcy Code. *See* ABC-NACO, Inc. v. Bank of Am., N.A. (In re ABC-Naco, Inc.), 331 B.R. 773, 778 (Bankr. N.D. Ill. 2005).

have or acquire concerning Borrower or to investigate or inform Guarantor of the financial or business condition or affairs of Borrower or any change therein;

(b) ***GUARANTOR WILL INDEMNIFY, DEFEND AND HOLD LENDER HARMLESS FROM AND AGAINST ANY LOSS, COST OR EXPENSE INCURRED OR ARISING AS A RESULT OF ANY REPRESENTATION, WARRANTY OR COVENANT OF GUARANTOR BEING FALSE, INCORRECT, INCOMPLETE OR MISLEADING IN ANY MATERIAL RESPECT***;[119] and

(c) Guarantor's representations, warranties, covenants, waivers and agreements set forth in this Guaranty are a material inducement to Lender to make the Loan to Borrower and to enter into the other Loan Documents and shall survive the execution hereof and any bankruptcy, foreclosure, transfer of security or other event affecting Borrower, Guarantor, any other Person, or any security for all or any part of the Guaranteed Obligations.[120]

[The following is an optional paragraph if Lender is concerned that ERISA may apply with respect to Guarantor]

4.6 [<u>Non-Application of ERISA or Similar State Laws</u>.[121] As of the date hereof and throughout the term of the Loan, (a) Guarantor is not and will not be (i) an "employee

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[119] *See* third annotation to <u>Section 2.2</u> (Guaranty of Performance), *supra*.

[120] The purpose of this provision is to help ensure that the representations, warranties and covenants made in the Guaranty will survive after execution of the documents. Lenders not only rely on the representations, warranties and covenants at the time of closing, but also rely on their accuracy after the closing of the transaction (for example in connection with future advances). In a bankruptcy, the trustee will seek opportunities to void certain contracts not in the best interest of the estate. Many of the representations and warranties, if not true, could be a potential opportunity to void the Guaranty (*i.e.*, insolvency or fraudulent inducement). By Guarantor acknowledging the survivorship of representations, warranties and covenants, the integrity of the Guaranty and the claims of the lender are protected. Courts have upheld contractual survivorship of representations and warranty provisions. *See* <u>TCI Cablevision of Tex., Inc. v. S. Tex. Cable Television, Inc.</u>, 791 S.W.2d 269 (Tex. App.–Corpus Christi, 1990, no writ) (upholding a provision in a contract that provided "all other representations and warranties made by Sellers shall survive the Closing for a period of two (2) years, in each case regardless of any investigation that may have been or may be made at any time by or on behalf of Buyer"). After the statute of limitations has begun to run, the lender will have generally have four years to bring suit against a guarantor for a breach of the guaranty. *See* fourth annotation to <u>Section 3.1(a)(iii)</u> for a discussion on the statute of limitations.

See annotation to <u>Paragraph B.</u> in the <u>Recitals</u>, *supra*, for general discussion of reliance and inducement issues with respect to consideration for the Guaranty.

[121] ERISA generally applies to employee benefit plans and preempts state law. Certain employee benefit plans are not subject to ERISA (such as employee benefit plans that cover state or local government employees), and are instead subject to state law. However, as many of the concepts in ERISA were borrowed from state trust law, similar concepts may be found in state law. The specifics of the discussion in this annotation apply to employee benefit plans that are subject to ERISA, as well as to individual retirement accounts or annuities ("IRAs"), Archer medical savings accounts, health savings accounts, and Coverdell education savings accounts (all of the foregoing collectively referred to as "Benefit Plans").

benefit plan", as defined in Section 3(3) of the Employee Retirement Income Security Act of 1974, as amended ("ERISA"); or (ii) a "plan" within the meaning of Section 4975(e)(1) of the Tax Code; (b) the assets of Guarantor do not and will not constitute "plan assets" within the meaning of the United States Department of Labor Regulations set forth in 29 C.F.R. §2510.3-101; (c) Guarantor is not and will not be a "governmental plan" within the meaning of Section 3(32) of ERISA; (d) transactions by or with Guarantor are not and will not be subject to state statutes applicable to Guarantor regulating investments of fiduciaries with respect to governmental plans; and (e) Guarantor shall not engage in any transaction which would cause any obligation, or action taken or to be taken, hereunder (or the exercise by Lender of any of Lender's rights under this Guaranty, the Note or the other Loan Documents) to be a prohibited transaction under ERISA or Section 4975 of the Tax

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Various consequences ensue if the assets of a Benefit Plan are involved in the transaction. Two significant consequences are (1) the possibility that the transaction as a whole, or a part of it, may be prohibited (in which case penalty taxes may need to be paid and the transaction may need to be significantly restructured), and (2) certain parties to the transaction would be fiduciaries of the Benefit Plan (and would therefore have the duty to act in the best interests of Benefit Plan participants and beneficiaries).

Fiduciaries of employee benefit plans that are subject to ERISA must act in accordance with their fiduciary duties when making decisions and taking actions with respect to such plans. *See* 29 U.S.C. § 1104 (2009). A fiduciary who violates such duties is personally liable for any losses caused by the breach and may be subject to civil penalties and other equitable sanctions. *See id.* §1109 and § 1132.

The assets of a Benefit Plan will be involved in the transaction if the benefit plan itself is a party to the transaction (as a borrower, lender or guarantor) or, in general, if Benefit Plans in the aggregate own 25% or more of any equity class of a party to the transaction.

ERISA and the Tax Code prohibit benefit plan fiduciaries and other parties related to the benefit plan, the benefit plan sponsor, or the benefit plan's administrators ("parties in interest" as defined in 29 U.S.C. § 1002(14) or "disqualified persons" as defined in I.R.C. § 4975(e)(2)) from engaging in certain transactions with benefit plans. Henceforth, we will use the terms "party-in-interest" and "prohibited transaction." If a prohibited transaction occurs, the party-in-interest is responsible for paying an excise tax and the prohibited transaction must be corrected. Some exemptions from the excise tax apply to IRAs, health savings accounts and Archer medical savings accounts in the event they lose their status as such as a result of engaging in a prohibited transaction, and to Coverdell education savings accounts that are otherwise taxable under I.R.C. § 530(d). The preferred way of correcting a prohibited transaction is to "undo" the transaction; however, other corrections may be available depending on the circumstances. The correction has the potential to cause a complete restructuring of the loan or guaranty. If the prohibited transaction is not corrected, an additional excise tax equal to 100% of the amount involved may apply.

The following transactions are prohibited, unless a statutory or regulatory exemption applies: (i) the direct or indirect sale, exchange, or leasing of property between a Benefit Plan and party-in-interest; (ii) the direct or indirect lending of money or other extension of credit between a Benefit Plan and a party-in-interest; (iii) the direct or indirect furnishing of goods, services, or facilities between a Benefit Plan and a party-in-interest; (iv) the direct or indirect transfer to, use by or for the benefit of, a party-in-interest of the income or assets of any Benefit Plan; (v) a fiduciary dealing with the income or assets of a Benefit Plan in his own interest or for his own account; (vi) a fiduciary receiving any consideration for his own personal account from any party dealing with the Benefit Plan in connection with a transaction involving the income or assets of the Benefit Plan; or (vii) a fiduciary acting in his individual or other capacity in any transaction involving an employee benefit plan subject to ERISA on behalf of a party (or representing a party) whose interests are adverse to the interest of such plan or the participants or beneficiaries of such plan. *See* 29 U.S.C. §§ 1106(a) & (b) (2009) and I.R.C. § 4975(c)(1). There are numerous statutory and regulatory exemptions that may apply, and the Department of Labor may grant individual exemptions under certain circumstances.

Code that is not exempt under a statutory or administrative class exemption. Guarantor further agrees to deliver to Lender such certifications or other evidence of compliance with the provisions of this Section 4.6 as Lender may from time to time request.]

ARTICLE V
SUBORDINATION OF CERTAIN INDEBTEDNESS

5.1 Subordination. If, for any reason whatsoever, Borrower or an Affiliate of Borrower is now or hereafter becomes indebted to Guarantor:[122]

(a) such indebtedness and all interest thereon and all liens, security interests, judgment liens, charges and other encumbrances and rights now or hereafter existing with respect to property of Borrower securing such indebtedness shall at all times be and remain inferior and subordinate in all respects to the Guaranteed Obligations and to any and all liens, security interests, judgment liens, charges and other encumbrances and rights now or hereafter existing upon Borrower's assets securing payment or performance of the Guaranteed Obligations, regardless of whether such liens, security interests, judgment liens, charges or other encumbrances or rights in favor of Guarantor or Lender presently exist or are hereafter created or attached;

(b) Guarantor shall not be entitled to enforce or receive, and shall not demand or accept, payment, directly or indirectly, of any such indebtedness of Borrower to Guarantor until the Guaranteed Obligations have been fully and finally paid and performed and all commitments to lend under the Loan Documents have terminated;[123]

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[122] A subordination provision is often included in a Guaranty because the lender does not want a borrower to pay obligations to a guarantor that might be an affiliate of the borrower before paying the lender. Allowing a borrower to do so would decrease the amount of cash flow available to repay the loan. If the lender is relying on subordination in determining a borrower's effective net worth and level of liquidity, a specific subordination agreement separate from the guaranty is often used. However, where additional funds may be loaned from a guarantor to a borrower, or where obligations of a borrower to a guarantor may arise, after the initial loan closing that either were not specifically contemplated at that time (or that otherwise are specifically prohibited by the other loan documents), this provision will enable the lender to obtain some of the basic protections and benefits without use of a broader agreement. Guarantors sometimes object to a subordination provision, most often in the case of affiliated entities operating as a common enterprise which need to move funds among the various entities for cash flow, timing and similar purposes.

For a general discussion of debt subordination in real estate transactions, *See* K.C. McDaniel, What do Lenders Really Want – Issues in Intercreditor Agreements, Real Estate Financing Documentation: Coping with New Realities (Am. Law Inst. – Am. Bar Ass'n. Continuing Legal Educ. 1996). *See also* Kevin C. Dooley and Thomas G. Rock, Subordination Agreements: Suggested Approaches to Key Issues, 113 BANKING L.J. 708 (July/Aug. 1996); Debra J. Schnebel, Intercreditor and Subordination Agreements – A practical Guide, 118 BANKING L.J. 48 (Jan. 2000).

[123] This Section 5.1(b) is often referred to as a "standstill" provision, whereby Guarantor agrees not to demand or accept payment by or from Borrower under other debt owed by Borrower to Guarantor until the Loan is repaid and performed in full. This provision serves a vital function for Lender by preventing Guarantor from directing funds away from Borrower that would otherwise be available to Borrower to improve Borrower's operations, enhance the value of the Mortgaged Property, or pay down the Loan. A lender may fear that payments

(c) Guarantor shall not exercise or enforce any creditors' rights it may have against Borrower until the Guaranteed Obligations have been fully and finally paid and performed and all commitments to lend under the Loan Documents have terminated;

(d) Guarantor shall not foreclose, repossess, sequester or otherwise take steps or institute any action or proceedings, judicial or otherwise (including, without limitation, the commencement of, or joinder in, any action or proceeding pursuant to any Debtor Relief Law),[124] to enforce any liens, mortgages, deeds of trust, security interests, collateral rights, judgments or other encumbrances held by Guarantor on assets of Borrower until the Guaranteed Obligations have been fully and finally paid and performed and all commitments to lend under the Loan Documents have terminated;

(e) Guarantor hereby assigns and grants to Lender a security interest in all such indebtedness and security therefor, if any, of Borrower to Guarantor now existing or hereafter arising, including any dividends and payments pursuant to any proceeding under or pursuant to any Debtor Relief Law. In the event of any proceeding under or pursuant to any Debtor Relief Law involving either Guarantor or Borrower as debtor, Lender shall have the right to prove its claim in any such proceeding so as to establish its rights hereunder and shall have the right to receive directly from the receiver, trustee or

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made by the borrower under other debt (whether secured or unsecured) owed to Guarantor may hinder, interfere with or disrupt the ability of the borrower to make its debt service payments as and when due under the Loan, and thus the lender may require that the Guaranty include subordination and standstill provisions to protect against these concerns.

There are several exceptions and variations of this concept which are often incorporated into a Guaranty. For example, some lenders will agree that Guarantor may receive payments on indebtedness owed by the borrower to Guarantor so long as no Default has occurred, thus creating, in effect, a "springing" standstill provision upon the occurrence of a Default. Other lenders may allow Guarantor to receive (so long as no Default exists) interest-only payments, but not principal payments, on such other debt until the Loan is repaid in full. Other common exceptions include: (i) partner, shareholder or member distributions made in the ordinary course of business, which are not really characterized as true "debt" (*sample language to add at the end of this <u>subparagraph (b)</u>*: "; provided, however, that so long as no Default exists under the Loan, Guarantor, as a general/limited partner of Borrower, may receive its portion of partnership distributions from Borrower made to partners of Borrower in the ordinary course of business and in accordance with Borrower's partnership agreement without such distributions being subject to the preceding limitations in this <u>subparagraph (b)</u>"); and (ii) property management fees, developer fees or other similar fees of which Lender is aware and has approved (*sample language to add at end of this <u>subparagraph (b)</u>*: "; except that so long as no Default exists under the Loan Documents, Guarantor may receive any property management fees payable to Guarantor as the property manager under the property management agreement with Borrower dated _______, any general contractor or construction supervision fees payable to Guarantor as the general contractor under the construction contract with Borrower, as owner, dated __________, and any other fees expressly allowed by Lender under the Loan Documents; provided, however, that all rights of Guarantor to receive any such fees and other sums shall be and hereby are made expressly subordinate to the rights of Lender under the Loan Documents"). Such alternatives to absolute subordination and standstill, and Lender's determination of whether to permit payments on debt owed by Borrower to Guarantor, and to what extent, is a matter for specific negotiation and is dependent, in large measure, on the particular facts and circumstances and the creditworthiness of the various parties.

[124] Section 510 of the Bankruptcy Code provides that a subordination agreement is enforceable in bankruptcy to the same extent that such agreement is enforceable under applicable nonbankruptcy law. *See* 11 U.S.C. § 510(c) (2009).

other custodian (whether or not a Default shall have occurred or be continuing under any of the Loan Documents), dividends and payments that are payable upon any obligation of Borrower to Guarantor now existing or hereafter arising, and to have all benefits of any security therefor, until the Guaranteed Obligations have been fully and finally paid and performed.[125] If, notwithstanding the foregoing provisions, Guarantor should receive any funds, payment, claim or distribution that is prohibited as provided above in this Section 5.1, Guarantor shall pay the same to Lender immediately, Guarantor hereby agreeing that it shall receive and hold the funds, payment, claim or distribution in trust for the benefit of Lender and shall have absolutely no right, either legal or equitable, to the same except to pay it immediately to Lender to be credited and applied to the Guaranteed Obligations, whether matured or unmatured; and

(f) Guarantor shall promptly upon request of Lender from time to time execute such documents and perform such acts as Lender may require to evidence and perfect its interest and to permit or facilitate the exercise of its rights under this Section 5.1, including, without limitation, execution and delivery of financing statements, proofs of claim, further assignments and security agreements, and delivery to Lender of any promissory notes or other instruments evidencing indebtedness of Borrower to Guarantor. All promissory notes, accounts receivable ledgers or other evidences, now or hereafter held by Guarantor, of obligations of Borrower to Guarantor shall contain a specific written notice thereon that the indebtedness evidenced thereby is subordinated under and is subject to the terms of this Guaranty.

ARTICLE VI
GENERAL PROVISIONS

6.1 Rights Cumulative. The exercise by Lender of any right or remedy hereunder or under any other Loan Document, or at law or in equity, shall not preclude the concurrent or subsequent exercise of any other right or remedy. Lender shall have all rights, remedies and recourses afforded to Lender by reason of this Guaranty or any other Loan Document or by law or equity or otherwise, and the same (i) shall be cumulative and concurrent, (ii) may be pursued separately, successively or concurrently against Borrower or Guarantor or other Persons obligated for the Guaranteed Obligations, or any part thereof, or against any one or more of them, or against any security or otherwise, at the sole and absolute discretion of Lender, (iii) may be exercised as often as occasion therefor shall arise, it being agreed by Guarantor that the exercise of, discontinuance of the exercise of or failure to exercise any of such rights, remedies

[125] Section 501 of the Bankruptcy Code provides for the filing of a proof of claim by a creditor. *See* 11 U.S.C. § 501 (2009). A proof of claim is a written statement setting forth a creditor's claim. *See id.* § 3001(a). When a claim is transferred prior to the filing of a proof of claim, as would be the case under this provision, the Bankruptcy Code provides that only the transferee of the claim has the right to file a proof of claim in a bankruptcy case. *See id.* § 3001(e)(1).

or recourses shall in no event be construed as a waiver or release thereof or of any other right, remedy or recourse, and (iv) are intended to be, and shall be, nonexclusive.[126]

6.2 Notices. All notices or other communications required or permitted to be given pursuant to this Guaranty shall be in writing and shall be considered as properly given if (i) mailed by first class United States mail, postage prepaid, registered or certified with return receipt requested, (ii) by delivering same in person to the intended addressee, (iii) by delivery to a reputable independent third party commercial delivery service for same day or next day delivery and providing for evidence of receipt at the office of the intended addressee, or (iv) by telefacsimile to the addressee. Notice so mailed shall be effective upon deposit with the United States Postal Service or any successor thereto; notice given by personal delivery shall be effective only if and when received by the addressee; notice sent by such a commercial delivery service shall be effective upon delivery to such commercial delivery service; and notice given by telefacsimile shall be effective only if and when received at the office or designated place or machine of the intended addressee. For purposes of notice, the addresses of the parties shall be as set forth on the signature page hereof; provided, however, that either party shall have the right to change its address for notice hereunder to any other location within the continental United States by the giving of 30 days' notice to the other party in the manner set forth above.[127]

6.3 Binding Effect. This Guaranty is binding on Guarantor **[and Guarantor's [executors, personal representatives,] successors and assigns]**; provided, however, that Guarantor may not, without the prior written consent of Lender in each instance, assign or delegate any of its rights, powers, duties or obligations hereunder, and any attempted assignment or delegation made without Lender's prior written consent shall be void *ab initio* and of no force or effect.[128] Upon the death of Guarantor, if Guarantor is a natural person, this Guaranty shall

[126] In the past, courts have indicated that the pursuit of certain remedies amounts to an election thereof by that party. For example, in the foreclosure context, non-judicial relief is not available after judicial relief is sought. *See* Baggett, Texas Foreclosure: Law and Practice § 1.66 (1984 & West 2008). Therefore, inclusion of the "rights cumulative" provision is designed to oppose any argument by a guarantor that the election of any right by the lender permitted under the loan documents is an election of that remedy to the exclusion of other rights or remedies otherwise available under the loan documents or at law or in equity. *See, e.g.*, Smith v. Olney Fed. Sav. & Loan Ass'n, 415 S.W.2d 515, 517 (Tex. Civ. App.–Eastland 1967, no writ); Norwood Homes, Inc. v. Marburger, 404 S.W.2d 687, 688 (Tex. Civ. App.–Eastland 1966, writ ref'd n.r.e.); Melcer v. Warren, 550 S.W.2d 760 (Tex. Civ. App.–Austin 1977, writ ref'd n.r.e.). *See also* annotation to Section 2.3(c) (Primary Liability of Guarantor), *supra*, and annotations to Section 3.1(a)(ix) (Certain Agreements and Additional Waivers by Guarantor), *supra*.

[127] If the lender inadvertently fails to give proper notice in any respect, the lender can generally remedy the situation by sending another notice. Notices ineffective for any reason do not necessarily bar later effective notices. *See also* first annotation on the Signature Page of this Guaranty, *infra*.

[128] *See* second annotation to this Guaranty, *supra*, regarding the definition of "Guarantor." The optional, bolded language in the first sentence in this Section 6.3 should be included if the definition of "Guarantor" at the beginning of the Guaranty is not sufficiently expansive to cover the named guarantor's "heirs, executors, personal representatives, permitted successors and permitted assigns," as applicable to the particular transaction. Similarly, the optional, bolded language in the fourth sentence in this Section 6.3 should be included if the definition of "Lender" at the beginning of the Guaranty is not sufficiently expansive to cover the named lender's "successors and assigns, any subsequent holder(s) of the Note, and any of its Affiliates providing an Interest Rate Protection Agreement," as applicable to a particular transaction. *See* third annotation to this Guaranty, *supra*, regarding the definition of "Lender."

continue in effect and be enforceable against Guarantor's estate as to all of the Guaranteed Obligations, including that portion incurred or arising after the death of Guarantor and shall be provable in full against Guarantor's estate, whether or not the Guaranteed Obligations are then due and payable.[129] If this Guaranty is signed by more than one Person, then all of the

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[129] As a general rule, contractual obligations survive the death of a party and are binding upon the decedent's estate. As previously noted in the second and third annotations to Section 2.1 (Guaranty of Payment), *supra*, a continuing guaranty may be revoked by the guarantor unless revocation is precluded by the language of the guaranty. *See also* Casey v. Gibson Prods. Co., 216 S.W.2d 266 (Tex. Civ. App.–Dallas 1948, writ dism'd). If revocation is not precluded by the guaranty, the death of the guarantor serves as a revocation, meaning that the guarantor's estate is not liable for any advancements made under the loan after the date of the guarantor's death. The guarantor's estate, therefore, will remain liable under the guaranty for loan advances made prior to the date of the guarantor's death *See* In re Seguin Hotel Corp., 2010 WL 2700429 at *5; Bexar County Ice Cream Co., Inc. v. Swensen's Ice Cream Co., 859 S.W.2d 402 (Tex. App.–San Antonio 1993, writ denied), *rev'd on other grounds*, Barraza v. Koliba, 933 S.W.2d 164 (Tex. App.–San Antonio 1996, writ denied); Tyler Bank & Trust Co. v. Shaw, 293 S.W.2d 797 (Tex. Civ. App.–Texarkana 1956, writ ref'd n.r.e.). Presumably, the guarantor's estate would remain liable for any post-death advances made under an irrevocable guaranty. However, the authors have found no Texas cases directly on point to confirm this presumption.

Lenders should recognize that the manner in which a claim under a guaranty is presented to the guarantor's estate will depend upon the type of estate administration involved. In Texas, the administration of a decedent's estate can be generally divided into two broad categories: (1) independent administration (where the personal representative of the estate generally administers the estate free of court supervision); and (2) dependent administration (where the administrative process is subject to the direct control and supervision of the probate court). The "default" under the Texas law is the dependent administration. An independent administration is created only if it is specifically provided for in the decedent's will or if all distributees of the estate agree as to the advisability of an independent administration and the court enters an order authorizing the independent administration. *See* TEX. PROB. CODE § 145(c) - (e) (West 2010).

Both dependent and independent administrations can present significant, and hidden dangers to a lender. First, a lender must formally present its claim to the administrator. If an unsecured creditor fails to formally present a claim within four months after receiving the permissive notice under Section 294(d) of the Texas Probate Code, the creditor's claim will be barred. *See id.* § 298(a). A secured claim must be presented within six months after the date letters of administration are granted by the probate court, or within four months of receiving notice pursuant to Section 295 of the Texas Probate Code, or else the claim will be barred. In a dependent administration, a claim must be presented either directly to the personal representative, or by filing in the court in which the administration of the estate is pending. In an independent administration, a claim must be presented either by (1) written instrument that is hand delivered with proof of receipt or mailed by certified mail, return receipt requested; (2) a pleading filed in a lawsuit with respect to the claim; or (3) a written instrument or pleading filed in the court in which the administration of the estate is pending.

Second, if the claim is a "claim for money," the claim must be authenticated. *See id.* § 301. A claim for money is a claim which is fixed, definite and susceptible of verification, including unmatured monetary claims. *See* Dunn v. Sublett, 14 Tex. 521 (1855). Depending upon the terms of the agreement, claims arising under a guaranty may or may not be a claim for money. For example, if the guaranty is a "guaranty of collection" or otherwise requires the joinder of the principal debtor, the amount of the guarantor's liability is uncertain and not subject to verification. If, however, the guaranty is a "guaranty of payment" which can be enforced without first looking to or joining the principal debtor, the claim may be a claim for money which would need to be formally presented to the administrator.

Third, a lender with a secured claim must make an election as to whether the claim is to be treated as (1) a matured secured claim; or (2) a preferred debt and lien against the specific property securing the indebtedness. If the lender elects to treat the claim as a matured secured claim, the indebtedness is paid in the ordinary course of the estate's administration. With this election, the lender may not conduct a non-judicial foreclosure on the property.

obligations of Guarantor arising hereunder shall be jointly and severally binding on each of the Persons signing this Guaranty, and their respective **[executors, personal representatives,]** successors and assigns (provided, however, that no Guarantor may, without the prior written consent of Lender in each instance, assign or delegate any of its rights, powers, duties or obligations hereunder, and any attempted assignment or delegation made without Lender's prior written consent shall be void *ab initio* and of no force or effect).[130] This Guaranty is for the

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Furthermore, if the claim is secured by real property the lender must also file its claim in the real property records in the county where the property is located. If, however, the lender elects to treat the claim as a preferred debt and lien, the claim is paid according to the contract securing the lien and may not be asserted against other assets of the estate. After six months, the lender would be free to conduct a non-judicial foreclosure, however, the lender may not seek any deficiency against the other assets of the estate. If no election is made, the claim will be treated as a preferred debt and lien.

If a claim is not properly presented or authenticated, the administrator can (and generally will) reject the claim. If a lender fails to file suit within 90 days of such rejection, the claim will be barred. *See* TEX. PROB. CODE § 313 (West 2010). In this regard, it is important to understand the nature of the "quickie rejection." This is a technique whereby the administrator quickly files a rejection of the claim with the probate court. An important element of this technique is the fact that the Texas Probate Code does not require the administrator to notify the creditor of the rejection. As a result, unless the creditor regularly checks the claims docket, the 90 days for filing suit might expire without the creditor's knowledge. Lenders should also be aware that unless the administrator allows the claim within 30 days of presentment, the claim is deemed rejected. *See id.* § 310.

The Texas Supreme Court in Bandy v. First State Bank, 835 S.W.2d 609 (Tex. 1992) upheld a lender's right to setoff a loan with funds in the decedent's checking account and CDs. The general rules from this case are (1) a lender has a right to setoff a decedent's debts without having to follow the statutory probate procedures; (2) the debt owed must be mature before a lender may exercise the right to setoff (but the debt did not have to mature prior to the decedent's death); and (3) the setoff may only be to the extent of the decedent's beneficial ownership in the CD/account.

For a detailed discussion of how claims under a guaranty are affected by the administration of a guarantor's estate, *see* C. Boone Schwartzel, Claims Procedure in Probate and Guardianship, STATE BAR OF TEXAS 25TH ANNUAL ADVANCED ESTATE PLANNING AND PROBATE COURSE (2001).

See also annotation to clause (iv) in the definition of "Default" in Section 1.1 (Definitions), *supra*.

[130] Lenders often require that multiple persons serve as guarantors of a loan. For example, two or more individuals or entities related to the borrower (*e.g.*, a parent company or sole individual shareholder), each with a high net worth or a strong credit history, may be asked to guarantee payment of the loan. In such a case, each such person should be required to sign the guaranty, or separate guaranties, as a guarantor. This provision for joint and several liability creates liability on the part of each Guarantor for payment and performance of the Guaranteed Obligations. Therefore, if one Guarantor should become unable to perform its obligations under the Guaranty, Lender could seek full performance from the other Guarantor(s). In the case of payment guarantors, each payment guarantor is liable as a co-borrower and each will have joint and several liability for the obligation. *See* first and fourth annotations to Section 2.1 (Guaranty of Payment), *supra*. Where liability is joint and several, the lender can proceed against any one guarantor or against all, or any combination of, guarantors with or without joining the borrower, and a release or discharge of a co-guarantor does not release the remaining guarantors. *See* Montgomery v. Boyd, 171 S.W. 273 (Tex. Civ. App.–Amarillo 1914, no writ). *See also* second annotation to this Guaranty regarding the definition of "Guarantor," *supra*.

Because the lender may require that more than one person guarantee the loan, the question then arises as to whether each Guarantor should sign a separate Guaranty or whether all Guarantors should sign one document. In addressing this issue, a prudent lender will consider these issues: (i) the extent and nature of each Guarantor's benefit of Lender **[and Lender's successors and assigns, any subsequent holder(s) of the Note [, and any of its Affiliates providing an Interest Rate Protection Agreement]]**. If the Guaranteed Obligations or any part thereof are assigned, the rights and benefits hereunder, to the extent applicable to the Guaranteed Obligations so assigned, may be transferred with such Guaranteed Obligations. Guarantor waives notice of any transfer or assignment of the Guaranteed Obligations, or any part thereof, and agrees that failure to give notice of any such transfer or assignment will not affect the liabilities of Guarantor hereunder.[131]

6.4 **Governing Law; Submission to Jurisdiction.**[132] **This Guaranty is executed and delivered as an incident to a lending transaction negotiated and consummated in**

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liability, (ii) the need for special provisions which may be applicable to some but not all of the Guarantors, (iii) ease of proving liability should the lender have to enforce the Guaranty through the judicial system, and (iv) proof of consideration. To assure clarity as to each Guarantor's obligations, the lender may elect to use separate Guaranties in the following situations: (a) some Guarantors have limited liability while others are guaranteeing the entire indebtedness, (b) the liability of all Guarantors is limited but in varying amounts or percentages, (c) some Guarantors have liability only under certain conditions, or the conditions under which each Guarantor's liability arises is different, or (d) certain Guarantors are liable only for the payment of the indebtedness but not the performance of all other obligations, while others are liable for performance of certain specific obligations. *See* Rider 1 (Limitations of Guaranteed Indebtedness), *infra*, for examples of limitations of the Guaranteed Indebtedness. In situations in which guarantors have differing relationships with a borrower or have negotiated different agreements, waivers, representations, warranties or covenants, lender may again find it advantageous to have separate documents for each guarantor. Counsel may decide that separate documents for each guarantor provide greater flexibility in devising litigation strategies. If a lender must pursue a remedy through the judicial system, a document unique to each guarantor may present an easier burden of proof. *See* annotations to Paragraphs B. and C. in the Recitals to this Guaranty, *supra*, for a discussion of how consideration may affect this decision. However, when all Persons constituting the Guarantor are to be jointly and severally liable for the Guaranteed Obligations, and are intended to guarantee the same liabilities and obligations, one document may be more appropriate than separate ones.

If a lender requires more than one Guarantor, the lender should consider including the following provision:

"If (i) this Guaranty is executed by more than one Person constituting the Guarantor, it is specifically agreed that Lender may enforce the provisions hereof with respect to one or more of such Persons constituting the Guarantor without seeking to enforce the same as to all or any such Persons; or (ii) one or more additional guaranty agreements ("Other Guaranties") are executed by one or more additional guarantors ("Other Guarantors"), which guarantee, in whole or in part, any of the indebtedness or obligations evidenced by the Loan Documents, it is specifically agreed that Lender may enforce the provisions of this Guaranty or of the Other Guaranties with respect to one or more of the Persons constituting the Guarantor or any one or more of the Other Guarantors under the Other Guaranties without seeking to enforce the provisions of this Guaranty or the Other Guaranties as to all or any of the Persons constituting the Guarantor or the Other Guarantors. Each Person constituting the Guarantor hereby waives any requirement of joinder of all or any other Person constituting the Guarantor or all or any of the Other Guarantors in any suit or proceeding to enforce the provisions of this Guaranty or of the Other Guaranties. The liability hereunder of all Persons constituting the Guarantor shall be joint and several."

[131] *See* third annotation to this Guaranty, *supra*, regarding the definition of "Lender." *See also* annotation to Section 6.7 (Participation; Disclosure of Information), *infra*.

[132] Parties to a commercial transaction will often choose the law that will govern some or all of the transaction. Texas law recognizes the parties' right to choose the law governing a transaction so long as the law selected has a reasonable relationship to the parties or their agreement and the chosen law does not thwart or offend Texas public policy. *See* DeSantis v. Wackenhut Corp., 793 S.W. 2d 670, 677 (Tex. 1990). The Texas legislature,

___________ County, Texas, and shall be governed by and construed in accordance with the Laws of the State of Texas.[133] **Guarantor, for itself and its successors and assigns,**

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however, subsequent to the DeSantis opinion, passed a statute effectively superseding the Texas Supreme Court's ruling in DeSantis, which further enabled parties to choose the law governing a transaction even if the chosen law is contrary to a fundamental public policy in Texas, so long as the transaction constitutes a "Qualified Transaction." This statute, Tex. BUS. & COM. CODE ANN. § 271.001 *et seq.* (West 2010), sets forth the contractual choice of law rules in transactions equal to or exceeding $1,000,000. *See* Tex. BUS. & COM. CODE ANN. § 271.005(b) (West 2010). Tex. BUS. & COM. CODE ANN. § 271.005(b) (West 2010) provides that if the parties to a "Qualified Transaction" agree in writing that "the law of a particular jurisdiction governs an issue relating to the transaction, including the validity or enforceability of an agreement relating to the transaction or a provision of the agreement and the transaction bears a reasonable relationship to that jurisdiction," then the law of such jurisdiction, without regard to conflict of law rules, will govern the issue, notwithstanding that the application of the law of another state is contrary to a fundamental public policy of Texas or of any other jurisdiction. *Id.* A "Qualified Transaction" is defined in Tex. BUS. & COM. CODE ANN. § 271.001(b) (West 2010) as a transaction in which a party "pays or receives or is obligated to pay or is entitled to receive, consideration with an aggregate value of at least $1 million, or lends, advances, borrows, or receives, or is obligated to lend or advance or is entitled to borrow or receive money or credit with an aggregate value of at least $1 million." *Id.* A transaction bears a "reasonable relation" to a jurisdiction under section 271.004 "if the transaction, the subject matter of the transaction, or a party to the transaction is reasonably related to the jurisdiction." *Id*. § 271.004. Further, a transaction bears a reasonable relation to a jurisdiction if one of the following five factors is present: "(1) a party to the transaction is a resident of that jurisdiction; (2) a party to the transaction has its place of business or, if the party has more than one place of business, its chief executive office or an office from which it conducts a substantial part of the negotiations relating to the transaction, in that jurisdiction; (3) all or a part of the subject matter of the transaction is located in such jurisdiction; (4) a party to the transaction is required to perform a substantial part of its obligations relating to the transaction, such as delivering payments, in that jurisdiction; or (5) a substantial part of the negotiations relating to the transaction, and the signing of an agreement relating to the transaction by a party to the transaction, occurred in that jurisdiction." *Id.* § 271.004. If, however, a portion of a parties' agreement would be invalid or unenforceable under the law of the chosen state, Section 271.004 provides that the law of the state with the "most significant relationship to the transaction ... governs the validity or enforceability of that term." *Id.* § 271.004). The law of the chosen state still governs the validity and enforcement of the other terms of the parties' agreement. *Id.* § 271.007. However, Section 271.004 excepts from the choice of law statute a determination of whether a transaction transfers or creates an interest in real property for security purposes or otherwise, the nature of the interest in real property that is transferred or created by a transaction, the process for foreclosure of a lien on real property, the nature of an interest in real property that results from foreclosure, or the manner and effect of recording or failing to record evidence of a transaction that creates an interest in real property. *Id.* § 271.008. The authors are unaware of any published case law in Texas interpreting § 271.001 or evaluating whether a particular transaction constitutes a "Qualified Transaction".

[133] This Guaranty contemplates a loan in which Texas law governs the entire transaction. Parties to a loan transaction often, however, designate the law of another jurisdiction to govern significant aspects of the transaction and will typically designate the laws of the State of Texas to govern all or only a portion of the remedial provisions of the deed of trust or certain of the other loan documents, such as a separate assignment of rents. In such cases, precision and care must be exercised in drafting the applicable choice of law provisions in order to appropriately bifurcate the aspects of the transaction to be governed by the laws of another jurisdiction. If the loan documents provide that the laws of the State of Texas are to govern only the remedial provisions, such choice of law provision needs to clearly and specifically identify that the remaining portions of the loan documents are to be governed by the laws of the other jurisdiction. By way of example, if a deed of trust makes specific reference to a note governed in its entirety by the laws of the State of New York, then a choice of law provision in the deed of trust indicating that the entirety of the deed of trust (and not solely the remedial portions thereof) is governed by the laws of the State of Texas, while the other loan documents (including the remedial portions thereof) are governed by the laws of the State of New York, is not only imprecise, but may create inconsistencies frustrating the intention of the parties to the transaction. If non-Texas collateral is pledged as security for the loan, lender's counsel must carefully consider issues of choice of law, enforcement of remedies (such as California's one action rule) and other state specific

hereby irrevocably (i) submits to the non-exclusive jurisdiction of the state and federal courts in the State of Texas, (ii) waives, to the fullest extent permitted by Law, any objection that it may now or in the future have as to the venue of any action, proceeding or litigation arising out of or in connection with this Guaranty or any Loan Document brought in the District Court of ___________ County, Texas, or in the United States District Court for the __________ District of Texas, _________________ Division, and (iii) agrees that any legal action or proceeding against Guarantor or any party to any Loan Document arising out of in connection with this Guaranty or any of the Loan Documents may be brought in any one of the foregoing courts.[134] Guarantor hereby agrees that service of process upon Guarantor may be made by certified or registered mail, return receipt requested, at its address specified herein. Nothing herein shall affect the right of Lender to serve process in any other manner permitted by Law or shall limit the right of Lender to bring any action or proceeding against Guarantor or with respect to any of Guarantor's property in courts in other jurisdictions. Any action or proceeding by Guarantor against Lender shall be brought only in a court located in ___________ County, Texas. The scope of each of the foregoing waivers is intended to be all encompassing of any and all disputes that may be filed in any court and that relate to the subject matter of this transaction, including, without limitation, contract claims, tort claims, breach of duty claims, and all other common law and statutory claims. Guarantor acknowledges that these waivers are a material inducement to Lender's agreement to enter into agreements and obligations evidenced by the Loan Documents, that Lender has already relied on these waivers and will continue to rely on each of these waivers in related future dealings. The waivers in this Section 6.4 are irrevocable, meaning that they may not be modified either orally or in writing, and these waivers apply to any future renewals, extensions, amendments, modifications, or replacements in respect of any and all of the applicable Loan Documents.

[*See Rider 4 for Foreign Guarantor Provisions.*]

6.5 Invalidity of Certain Provisions; Severability. If any provision of this Guaranty or the application thereof to any Person or circumstance shall, for any reason and to any extent, be judicially declared to be invalid or unenforceable, then neither the remaining provisions of this Guaranty nor the application of such provision to any other Person or circumstance shall be affected thereby, and the remaining provisions of this Guaranty, or the applicability of such

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matters so that the loan documents, including the guaranty, are enforceable in the manner approved by the lender. Retaining help of qualified local counsel is highly recommended.

[134] The Texas Civil Practice and Remedies Code provides that parties to a "major transaction" may choose the venue for an action arising from that major transaction. *See* TEX. CIV. PRAC. & REM. CODE ANN. § 15.020 (West 2010). The choice of venue must be contained in a written agreement and a "major transaction" is defined as a non-consumer transaction evidenced by a written agreement under which a person pays, receives or is obligated to pay consideration greater than or equal to $1,000,000.00. *See id.*

provision to other Persons or circumstances, as the case may be, rather shall remain in effect and be enforceable to the maximum extent permitted by applicable Law.[135]

6.6 Attorneys' Fees and Costs of Collection. Guarantor shall pay on demand all attorneys' fees and all other costs and expenses incurred by Lender in the enforcement of or preservation of Lender's rights under this Guaranty, including, without limitation, all attorneys' fees and expenses, investigation costs, and all court costs, whether or not suit is filed hereon, or whether (i) at maturity or by acceleration, or (ii) before or after maturity, or (iii) in connection with bankruptcy, reorganization, insolvency or appeal, or (iv) in connection with the collection or enforcement of this Guaranty against Guarantor or any Guarantor, if there is more than one. Guarantor agrees to pay interest on any expenses or other sums due to Lender under this Section 6.6 that are not paid when due, at a rate per annum equal to the lesser of (i) the Maximum Lawful Rate, or (ii) the Default Interest Rate. Guarantor's obligations and liabilities under this Section 6.6 shall survive any payment or discharge in full of the Guaranteed Obligations.[136]

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[135] Section 6.5 attempts, by making the various provisions of the Guaranty "severable" from the whole of the Guaranty, to preclude the invalidity or unenforceability of the Guaranty and the other provisions contained in the Guaranty if for some reason certain specific provisions of the Guaranty are found to be invalid or unenforceable for any reason.

[136] Even if the Guaranty does not contractually provide for the recovery of attorneys' fees in connection with pursuit or collection of the debt, Texas law provides for recovery of attorneys' fees on a contract, either written or oral. *See* TEX. CIV. PRAC. & REM. CODE ANN. § 38.001(8) (West 2010). *See also* Lyons v. Montgomery, 701 S.W.2d 641, 643 (Tex. 1985); F.R. Hernandez Constr. & Supply Co. v. Nat'l Bank of Commerce, 578 S.W.2d 675, 677 (Tex. 1979); Edwin M. Jones Oil Co. v. Pend Oreille Oil & Gas Co., 794 S.W.2d 442, 449 (Tex. App.–Corpus Christi 1990, writ denied); *but see* Jeffreys v. McGlamery, 96 S.W.2d 572, 576 (Tex. Civ. App.–Amarillo 1936, no writ) (holding that loan documents must specifically provide for reimbursement of attorneys' fees and expenses incurred by the lender or the trustee in order to receive such reimbursement). It should be noted that the Jeffreys case has not been cited by other courts. Section 38.002(3) of the Texas Civil Practice and Remedies Code requires presentment of the claim for the recovery of attorney's fees by demand letter 30 days before or after filing suit but, in any case, no later than 30 days before entry of judgment. *See* TEX. CIV. PRAC. & REM. CODE ANN. § 38.002(3) (West 2010). No particular form of demand or presentment is required. An original complaint containing a demand for payment which was not answered by the defendant with a tender of payment has been found to constitute presentment. *See* Boehringer Mannheim Diagnostics, Inc. v. Pan Am. World Airways, Inc., 531 F. Supp. 344, 354 (S.D. Tex. 1981), *rev'd in part on other grounds*, 737 F.2d 456 (5th Cir. 1984), *cert denied*, 469 U.S. 1186 (1985). Many state courts hold, however, that the filing of a lawsuit by itself does not constitute a sufficient presentment pursuant to the statute. *See* European Import Co. v. Lone Star Co., 596 S.W.2d 287, 291 (Tex. Civ. App.–Houston [1st Dist.] 1980, writ ref'd n.r.e.); Sterling Constr. Co. v. W. Tex. Equip. Co., 597 S.W.2d 515, 518 (Tex. Civ. App.–Amarillo 1980, no writ). But responses to requests for admissions may constitute a sufficient presentment. *See* Thompson v. Starr Realco, Inc., 648 S.W.2d 25, 29 (Tex. App.–Tyler 1983, writ ref'd n.r.e.); Welch v. Gammage, 545 S.W.2d 223, 226 (Tex. Civ. App.–Austin 1976, writ ref'd n.r.e.).

Section 6.6 contractually provides for Guarantor's obligation to pay Lender's collection costs. These costs accrue interest at the Default Interest Rate in order to encourage Guarantor to promptly pay these costs. *See also* annotations to definitions of "Default Interest Rate" and "Maximum Lawful Rate" in Section 1.1 (Definitions), *supra*, annotation to clause (D) of Section 3.1(a)(xv) (Certain Agreements and Additional Waivers by Guarantor), *supra*, and annotation to Section 6.17 (Controlling Agreement), *infra*, for discussion of usury in the context of a Guaranty.

6.7 Participation; Disclosure of Information. Lender may, from time to time and without notice to Guarantor, sell or offer to sell the Loan, or interests therein, to one or more assignees or participants and is hereby authorized to disseminate and disclose any information (whether or not confidential or proprietary in nature) Lender now has or may hereafter obtain pertaining to Guarantor, this Guaranty, the Loan or the Guaranteed Obligations (including, without limitation, any credit or other information regarding Guarantor, Borrower, any of their principals, or any other Person liable, directly or indirectly, for any part of the Guaranteed Obligations), to (i) any assignee or participant or any prospective assignee or prospective participant, (ii) any of Lender's Affiliates, (iii) any regulatory body having jurisdiction over Lender or the Loan, and (iv) any other Persons as may be necessary or appropriate in Lender's reasonable judgment. Guarantor shall execute, acknowledge and deliver any and all instruments reasonably requested by Lender in connection therewith and, to the extent specified in any of the documents evidencing any such assignment or participation, any assignee or participant shall have the rights and benefits with respect to this Guaranty and the other Loan Documents as any such assignee or participant would have had if any such assignee or participant had been Lender hereunder. Lender, as a courtesy to Guarantor, will endeavor to notify Guarantor of any such assignees or participants, or prospective assignees or participants, to which Lender disseminates any of the information described above in this Section 6.7 **[and will instruct all parties receiving such information to treat all such information as confidential in nature]**.[137]

See also second annotation to Section 2.3(b) (Primary Liability of Guarantor), *supra*, for general discussion of Lender's remedies.

[137] A lender may desire to expressly reserve the right to sell or to offer to sell the loan or any interest therein to one or more assignees or participants and to disseminate certain information in connection with such a sale or offer to sell. This provision helps to avoid a potential conflict or claim by Guarantor that the lender unlawfully disclosed confidential or proprietary information to such parties. Any such provision should impose an obligation on Guarantor to execute, acknowledge and deliver any instruments reasonably requested by the lender in connection with such assignment or participation, which may include, for example, an acknowledgment by Guarantor that the assignees or participants have rights (subject to the rights of the lender, the "lead" bank or the "agent" bank) to enforce Guarantor's obligations under the Guaranty. If this provision is included in the Guaranty, a similar provision should also be incorporated into the other Loan Documents executed by Borrower. *See also* third annotation to this Guaranty, *supra*, regarding the definition of "Lender."

As the holder of the Guaranty, the lender has a right to receive information concerning Guarantor (such as financial statements and other credit information concerning Guarantor – *see* Section 4.2 [Financial Statements and Reporting Requirements], *supra*). The lender is generally not entitled to disclose confidential, non-public information concerning Guarantor to third parties because doing so can potentially affect Guarantor's creditworthiness or its competitive position. The lender should clarify with Guarantor what information is to be considered confidential, and thus this information should be afforded heightened protection. Once information is classified as confidential, the lender and Guarantor should agree on a standard of handling such information. The lender may agree to use its best efforts to keep the information confidential or may covenant to keep the information absolutely confidential. The range will be dictated by Guarantor's negotiating power and the nature of the information itself.

The lender also should institute strict procedures regarding confidentiality and a means of transferring such information about the guarantor to parties that may require the information, such as bank regulators, certain firms and individuals who perform an advisory role, and the courts pursuant to any legal processes. A lender often contemplates or intends to sell an interest in the loan to a third party. This would require disclosure of information about the guarantor relevant to the sale of such an interest. It would be prudent to deal with these disclosure issues

6.8 Right of Setoff.[138] Whenever a Default exists, Lender shall have, and Guarantor hereby grants to Lender, a lien upon and a right to setoff and apply against this Guaranty or the

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during the negotiating and documentation process instead of waiting later to interrupt the parties' intentions in litigation.

Some lenders may be concerned about the privacy issues addressed in the Gramm-Leach-Bliley Act ("GLBA"). GLBA establishes rules governing the protection and disclosure by financial institutions of nonpublic personal information about consumers (but not information about businesses or corporations); *See* 15 U.S.C. §§6801-6809 (addressing financial privacy and safeguarding of consumer information), 15 U.S.C. §§6821-6827 (addressing fraudulent access to consumer information ("pretexting"). GLBA establishes rules governing the protection and disclosure by financial institutions of nonpublic personal information about consumers (but not information about businesses or corporations). *See* GRAMM-LEACH-BLILEY ACT §509(9) (defining the term "consumer" as "an individual who obtains, from a financial institution, financial products or services which are to be used primarily for personal, family or household purposes) . This Guaranty relates to a commercial real estate loan and therefore GLBA's consumer privacy protection provisions are not applicable in this instance. However, although beyond the scope of this discussion, lenders should be aware of potential securities liability associated with disseminating confidential non-public information to the public.

[138] A depository institutional lender in Texas, as in many states, has a right as a creditor to setoff against or reduce certain matured debt by an amount equal to funds held in a deposit account of the borrower maintained with the lender. *See* TEX. FIN. CODE ANN. § 34.307 (West 2010). *See also* Sears v. Cont'l Bank & Trust Co., 562 S.W.2d 843, 844 (Tex. 1977) (the bank had the right to setoff against an amount on deposit an equal amount of indebtedness owed by the depositor to the bank; however, the bank had the burden of proving the indebtedness which justified the bank's deduction from borrower's account). Notwithstanding this line of authority, there appears to be no statutory right of setoff against a *guarantor* under Texas law. *See* TEX. FIN. CODE ANN. § 34.307 (West 2010) (tying the right of setoff to a depositor "to whom or on whose behalf the bank has made an advance of money by loan, overdraft, or otherwise."). We also are unaware of any published Texas case holding directly on whether a depository institution lender in Texas has a common law right, as a creditor, to setoff deposits against indebtedness *guaranteed* by the depositor. Courts in other states, however, have recognized a bank's right to setoff a depositor's account against matured indebtedness guaranteed by that depositor. S*ee, e.g.,* Munday v. Bank of Franklin, 189 S.E. 779 (N.C. 1937). In Pioneer Nat'l Bank of Arlington v. Bakutis, 784 S.W.2d 440 (Tex. App.—Fort Worth 1989, no writ) (noting that "[t]here is authority to the effect that a bank has no right, without the depositor's consent, to apply his deposit on a debt where he is a mere guarantor"), the court implied that a contractual setoff right would be recognized. Accordingly, a lender in Texas should obtain a guarantor's express, written consent to the lender's right of setoff, as in this Section 6.8.

The elements of a valid and proper setoff are (i) the debt and the relationship of a lender and a debtor must both be in existence, (ii) the debt must have matured (unless the debtor or debtor's estate is insolvent), (iii) mutuality of obligation must exist, (iv) the debtor must be the owner of the funds, and (v) the account must be a general as opposed to a special account. *See* Bandy v. First State Bank Overton, Tex., 835 S.W.2d 609 (Tex. 1992) for a general discussion of the foregoing. A general account is one deposited without restrictions; the funds deposited become the property of the depository institution and a debtor/creditor relationship is established between the depository institution and the depositor. *See id.* at 618; *see also* Hudnall v. Tyler Bank & Trust Co., 458 S.W.2d 183, 186 (Tex. 1970). A special account, on the other hand, is created when a depositor deposits funds for a specific, special, limited or particular purpose. The relationship between the depository institution and the depositor with respect to a special account is not one of debtor/creditor, but rather of bailor/bailee. *See* Bandy, 835 S.W.2d at 619; Hudnall, 458 S.W.2d at 186; Lee v. Gutierrez, 876 S.W.2d 382, 385 (Tex. App.—Austin 1994, writ denied).

Although delivering written notice prior to setoff is prudent practice, unless contractually required the lender is not always required to do so. *See* TEX. FIN. CODE ANN. § 34.407(a) (West 2010). *See also* Elizarraras v. Bank of El Paso, 631 F.2d 366, 372 (5th Cir. 1980); Baldwin v. Peoples Nat'l Bank, 327 S.W.2d 616, 620-22 (Tex. Civ. App.–Texarkana 1959, no writ). However, the lender should disclose the right of setoff to a guarantor prior to exercising that right. *See* TEX. FIN. CODE ANN. § 34.307(a) (West 2010). There also may be a constitutional

Guaranteed Obligations or both, at any time and from time to time, to the fullest extent permitted by applicable Law, without demand upon or notice to Guarantor or any other Person (any such demand or notice being hereby expressly waived by Guarantor to the fullest extent permitted by applicable Law), (i) any and all money, securities, deposits (general or special, time or demand, provisional or final), funds, assets or other property of Guarantor now or at any time hereafter held by, in possession of, or on deposit with, Lender, whether held in a general or special account or deposit, for safe-keeping or otherwise, and (ii) any and all other indebtedness at any time owing by Lender to or for the credit or the account of Guarantor, any and all of which may be applied against any and all of the Guaranteed Obligations, whether or not Lender shall have made any demand under this Guaranty or exercised any other right or remedy hereunder and although such obligations may be unmatured. Lender will endeavor to promptly notify Guarantor after any such setoff and application made by Lender, provided that the failure to give such notice shall not affect the validity of such setoff and application. No lien or right of setoff shall be deemed to have been waived by any act or conduct on the part of Lender, or by any neglect to exercise such right of setoff or to enforce such lien, or by any delay in so doing. The rights of Lender under this Section 6.8 are in addition to all other rights and remedies (including other rights of setoff) that Lender may have under this Guaranty and under applicable Law, and every right of setoff and lien shall continue in full force and effect until such right of setoff or lien is specifically waived or released by a written instrument executed by Lender.

6.9 No Waiver. The rights of Lender hereunder shall be in addition to all other rights of Lender under the other Loan Documents or provided by Law. No modification or waiver of any provision of this Guaranty, or consent to departure therefrom, or any release or discharge, shall be effective unless in writing and executed and delivered by Lender to Guarantor. No waiver of any Default or of any breach of any of the provisions of this Guaranty or of any other Loan Document shall be considered a waiver of any other or subsequent Default or breach, and no delay or omission in exercising or enforcing the rights and powers granted herein or in any other Loan Document shall be construed as a waiver of such rights and powers, and no exercise or enforcement of any rights or powers hereunder or under any other Loan Document shall be held to exhaust such rights and powers, and every such right and power may be exercised from time to time. The granting of any consent, approval or waiver by Lender shall be limited to the specific instance and purpose therefor and shall not constitute consent, approval or waiver in any other instance or for any other purpose, and no consent, approval or waiver by Lender shall extend beyond the particular case and purpose specifically stated therein. No notice to or demand on Guarantor in any case shall constitute a waiver of the right to take other action in the same, similar or other instances without such notice or demand, or shall of itself entitle Guarantor to any other or further notice or demand in the same, similar or other circumstances. No provision of this Guaranty or any right, remedy or recourse of Lender with respect hereto, or any Default or breach, can be waived, and neither this Guaranty nor Guarantor shall be released or discharged in any way or to any extent, except specifically in each case by a writing intended

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limitation. The U.S. Supreme Court has held that a debtor must be given notice and opportunity to be heard prior to any **state** action depriving the debtor of property. *See* Sniadach v. Family Fin. Corp., 395 U.S. 337 (1969).

for that purpose (and which refers specifically to this Guaranty) executed and delivered by Lender to Guarantor.[139]

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[139] Waiver is an intentional abandonment or relinquishment of a known right or advantage. *See* Mass. Bonding and Ins. Co. v. Orkin Exterminating Co., 416 S.W.2d 396, 401 (Tex. 1967). It may result from implication and usage or from an understanding between parties. *See* Preston Tower Condo. Ass'n. v. S. B. Realty, Inc., 685 S.W.2d 98, 103 (Tex. Civ. App.–Dallas 1985, no writ). Waiver is essentially unilateral, it results as a legal consequence from some act or conduct of the party against whom waiver is sought and it need not be founded upon a new agreement or supported by consideration. *See* U.S. Fid. & Guar. Co. v. Bimco Iron & Metal Corp., 464 S.W.2d 353, 358 (Tex. 1971). A party with full knowledge of the material facts that fails to require the performance that such party has a right to require, has been held to waive such right. *See* Scherer v. Wahlstrom, 318 S.W.2d 456 (Tex. App.–Fort Worth 1958, writ ref'd). Accordingly, the elements of waiver can be summed up as the intentional relinquishment of a right that the party actually knows exists, or of which such party has constructive knowledge. *See* Ford v. Culbertson, 308 S.W.2d 855, 864 (Tex. 1958); Cattle Feeders, Inc. v. Jordan, 549 S.W.2d 29 (Tex. Civ. App.–Corpus Christi 1977, no writ). *See generally*, Edward A. Peterson and John M. Nolan, Lender's Remedies: What Worked and What Didn't, Advanced Real Estate Law Course, State Bar of Texas (1991).

Furthermore, it has been held that a non-waiver provision such as the one contained in this Guaranty does not necessarily preclude the waiver of such non-waiver provision. *See* Winslow v. Dillard Dep't Stores, Inc., 849 S.W.2d 862, 863-864 (Tex. App.–Texarkana 1993, writ denied); Zwick v. Lodewijk Corp., 847 S.W.2d 316, 318 (Tex. App.–Texarkana 1993, writ denied). In that regard, the main element of waiver is intention. *See* Heinrich v. Wharton County Livestock, Inc., 557 S.W.2d 830, 834 (Tex. Civ. App.–Corpus Christi 1977, writ ref'd, n.r.e.); Smith v. City of Dallas, 425 S.W.2d 467 (Tex. Civ. App.–Dallas 1968, no writ). The intent to waive a right may be either express or implied. *See* Lang v. Lee, 777 S.W.2d 158, 164 (Tex. App.–Dallas 1989, no writ). However, waiver by implication will only be applied to prevent fraud or other inequitable consequences. *See* Shook v. Republic Nat'l Bank, 627 S.W.2d 741 (Tex. Civ. App.–Tyler 1981), *rev'd on other grounds*, 653 S.W.2d 278 (Tex. 1983).

A claim of continuing waiver is an attempt by Guarantor to use a waiver of a Default in one instance as a waiver for that same Default in all instances until the lender requires strict compliance with the terms of the Guaranty. Section 6.9 attempts to preclude the argument that a "course of conduct" between the parties established a new and contradictory contractual term. However, under the cases previously discussed, such an argument by the lender might not prevail if the lender has, in fact, continually waived a specific Default over a period of time without requiring strict compliance. In such a case, a prudent course of action is for the lender to notify Guarantor in writing that strict compliance with the terms of the Guaranty will be thereafter required. Such a notice is intended to effectively contradict and defeat Guarantor's course of conduct/continuing waiver argument and cure any past waiver problem.

A finding of waiver depends upon the particular facts in each case. *See* Dobson v. Dobson, 594 S.W.2d 177 (Tex. Civ. App.–Houston [1st Dist.] 1980, writ ref'd. n.r.e.). Normally, waiver is decided by the fact-finder after evidentiary presentation of all the facts relevant to an intentional and knowing relinquishment of a known right. While most cases do not discuss whether the facts reviewed in the appellate opinion constitute waiver, factually or as a matter of law, prior cases involving the same facts could be cited as authority for or against a finding of waiver as a matter of law. Waiver fact patterns not previously given legal review remain questions for the finder of fact. If, however, the parties have contractually agreed to the legal effect of factual circumstances, the parties are generally bound by the agreed and enforceable contractual provisions, whether such provisions are labeled "waiver clauses" or otherwise.

Moreover, to forestall the possible argument that a subsequent oral agreement (or silence or other action or inaction of the parties) can modify the Guaranty or release Guarantor from its obligations, this Guaranty specifically requires that any such agreement, modification, waiver or release must be in writing signed by the lender.

See also, generally, annotations to Section 2.5 (Waiver), *supra*.

6.10 Further Assurances and Corrections. From time to time, at the request of Lender, Guarantor will (i) promptly correct any defect, error or omission which may be discovered in the contents of this Guaranty or in any other Loan Document executed by Guarantor or in the execution or acknowledgment thereof; (ii) execute, acknowledge, deliver and record or file (or cause to be executed, acknowledged, delivered and recorded or filed) such further documents and instruments and perform such further acts and provide such further assurances as may be necessary, desirable, or proper, in Lender's opinion, (A) to carry out more effectively the purposes of this Guaranty and the other Loan Documents and the transactions contemplated hereunder and thereunder, (B) to confirm the rights created under this Guaranty and the other Loan Documents, (C) to protect and further the validity, priority and enforceability of this Guaranty and the other Loan Documents and the liens and security interests created thereby, and (D) to subject to the Loan Documents any property of Guarantor intended by the terms of any one or more of the Loan Documents to be encumbered by the Loan Documents; and (iii) pay all costs in connection with any of the foregoing.[140]

6.11 Relationship of the Parties; No Fiduciary Relationship. Notwithstanding any prior business or personal relationship between Guarantor and Lender, or any officer, director or employee of Lender, that may exist or have existed, the relationship between Lender and Guarantor is solely that of lender and guarantor. Guarantor and Lender are not partners or joint venturers, and no term or condition of any of the Loan Documents shall be construed so as to deem the relationship between Guarantor and Lender to be other than that of guarantor and lender. Lender has no fiduciary or other special relationship with or duty to Guarantor and none is created hereby or may be inferred from any course of dealing or conduct or act or omission of Lender.[141]

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[140] Generally, a covenant of "further assurances" is a covenant that Guarantor will, on demand, perform all acts necessary to provide further assurances of the Guaranteed Obligations (such as to correct errors or defects in the Guaranty, and to execute such further documents as may be necessary or appropriate to confirm Guarantor's obligations, and the lender's rights, under the Guaranty and to protect the validity and enforceability of the Guaranty). *See* New Marshall Engine Co. v. Marshall Engine Co., 223 U.S. 473 (1912), where the United States Supreme Court upheld an action for specific performance of a covenant of further assurances. *See also* New Jersey v. Del., 291 U.S. 361 (1934). Guarantor should be cautious, however, that any such future documents and "further assurances" do not have the effect of otherwise increasing Guarantor's obligations under the Guaranty or imposing new or additional Guaranteed Obligations other than those stated in the Guaranty. *See also* annotation to Section 3.1(a)(viii) (Certain Agreements and Additional Waivers by Guarantor), *supra*, regarding modification of underlying obligation. If a further assurance covenant is not included in the Guaranty, or is for some reason held to be unenforceable, the lender will be forced to rely on its common law rights to correct any defects, errors and omissions by asserting that fraud or a mutual mistake has occurred.

[141] The relationship between Guarantor and the lender is that of debtor-creditor. This provision is included to have Guarantor acknowledge that there is no fiduciary or special relationship with Lender that would impose either fiduciary or special duties upon Lender. Texas courts have recognized that a duty exists or arises when there is either a fiduciary relationship or a special relationship.

Under Texas law there is no general fiduciary obligation between a lender and a borrower or between business parties, and the courts have held that a debtor-creditor relationship does not of itself create a fiduciary relationship. *See* Thigpen v. Locke, 363 S.W.2d 247, 253 (Tex. 1962) (the debtor-creditor relationship alone does not create a fiduciary relationship); Thomas v. Norton, 604 S.W.2d 473, 476 (Tex. Civ. App.—Dallas 1980, no writ) ("the fact that . . . an officer of the bank . . . made a loan of the amount of the purchase price does not raise a confidential relationship"); Winston v. Lake Jackson Bank, 574 S.W.2d 628 (Tex. Civ. App.—Houston [14th Dist.] 1978, no writ) (testimony as to "extensive prior dealings" between a borrower and a lender and that lender's president had been a borrower's financial advisor was not sufficient evidence to demonstrate a fiduciary relationship); Consol. Bearing & Supply Co. v. First Nat'l Bank at Lubbock, 720 S.W.2d 647 (Tex. App.—Amarillo 1986, no writ) (court relied on Thomas and Winston in holding that a debtor-creditor or bank-depositor relationship is not a fiduciary relationship); Fina Supply, Inc. v. Abilene Nat'l. Bank, 726 S.W.2d 537, 540 (Tex. 1987) (issuance of a letter of credit does not create a fiduciary duty to the beneficiary of a letter of credit); In re Letterman Bros. Energy Secs. Litig., 799 F.2d 967, 975 (5th Cir. 1986), *cert denied*, 480 U.S. 918 (1987) (the court held "under Texas law there is no general fiduciary obligation between a lender and a borrower or between business parties").

Although there ordinarily is not a fiduciary relationship, courts have held that a circumstance could exist that would give rise to the duty of good faith and fair dealing. *See* Kinzbach Tool Co. v. Corbett-Wallace Corp., 160 S.W.2d 509 (Tex. 1942) (explaining the term "fiduciary" contemplates good faith and fair dealing). This fiduciary duty may arise from informal, moral, social, domestic, or personal dealings as well as technical relationships. *See* Thigpen, 363 S.W.2d at 253; Winston, 574 S.W.2d at 629. The existence of the fiduciary relationship is to be determined from the actualities of the relationship between the persons involved. *See* Thigpen, 363 S.W.2d at 253. Courts have attempted to set guidelines as to when the nature of a relationship would constitute classifying it as a "fiduciary" relationship. In Texas Bank & Trust Co. v. Moore, 595 S.W.2d 502, 507 (Tex. 1980), the court stated that a fiduciary relationship exists where a special confidence is reposed in another who in equity and good conscience is bound to act in good faith and with due regard to the interests of the one reposing confidence. In resolving whether a fiduciary relationship exits, courts have scrutinized the transactions between parties where trust and confidence is reposed by one, and personal profit is gained by another. *See* Stephens County Museum, Inc. v. Swenson, 517 S.W.2d 257 (Tex. 1974); Archer v. Griffith, 390 S.W.2d 735 (Tex. 1964). In Earl Park State Bank v. Lowman, 161 N.E. 675 (Ind. App. 1928), a bank was held liable to a borrower, where ordinarily there is no fiduciary relationship, for its officer's failure to disclose a known material fact where there had been a long-standing relationship between the bank officer and the borrower, and where the officer had recommended the loan and had negotiated its terms. The United States Court of Appeals for the Fifth Circuit has determined that a Texas court examining the facts of Earl Park State Bank likely would have found a fiduciary relationship to exist under Texas law. *See* In re Letterman Bros., 799 F.2d at 975. Although it is not clear what circumstances would give rise to a fiduciary relationship between a borrower or guarantor and a lender, it is clear that subjective reliance or trust alone is insufficient to establish a fiduciary relationship. *See* Thigpen, 363 S.W.2d at 253. Nor are extensive prior dealings by themselves enough to create such a relationship. *See id.* In addition, the Texas Supreme Court has held that there is not an implied covenant of good faith and fair dealing in every contract. *See* English v. Fischer, 660 S.W.2d 521 (Tex. 1983). *But see* TEX. BUS. & COM. CODE § 1.304 (West 2010) (stating "[e]very contract or duty within this title imposes an obligation of good faith in its performance or enforcement.").

Although the existence of a "special relationship" creates the duty of good faith, Texas courts have held that this relationship does not apply to the relationship of creditor-guarantor. *See* F.D.I.C. v. Coleman, 795 S.W.2d 706, 709 (Tex. 1990) (stating the relationship between a creditor and guarantor does not ordinarily import a duty of good faith). The Coleman court stated further 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. *See id.* at 708. However, the Coleman court noted that the plaintiff did not plead the existence of a special relationship between the creditor and guarantor and therefore they did not have to decide whether to extend a duty of good faith and fair dealing to this context, which they have recognized in other contexts. *See id*. This leaves the door open to the possibility of finding a special relationship in certain factual circumstances. For example, Texas courts have found a special relationship to exist (i) between insureds and insurers (*see* Aranda v. Ins. Co. of N. Am., 748 S.W.2d 210 (Tex. 1988); Arnold v. Nat'l County Mut. Fire Ins. Co., 725 S.W.2d 165, 167 (Tex. 1987)) and (ii) in relation to executive rights in oil and gas leases (*see* Manges v. Guerra, 673 S.W.2d 180 (Tex. 1984)).

6.12 Time of Essence. Time is of the essence in this Guaranty with respect to all of Guarantor's obligations hereunder.[142]

6.13 Counterparts. To facilitate execution, this Guaranty may be executed in as many counterparts as may be convenient or required. It shall not be necessary that the signature and acknowledgment of, or on behalf of, each Person, or that the signature and acknowledgment of all Persons required to bind any Person, appear on each counterpart. All counterparts shall collectively constitute a single instrument. It shall not be necessary in making proof of this Guaranty to produce or account for more than a single counterpart containing the respective signatures and acknowledgment of, or on behalf of, each of the Persons hereto. Any signature and acknowledgment page to any counterpart may be detached from such counterpart without impairing the legal effect of the signatures and acknowledgments thereon and thereafter attached to another counterpart identical thereto except having attached to it additional signature and acknowledgment pages.

6.14 Recitals. The recital and introductory paragraphs hereof are a part hereof, form a basis for this Guaranty and shall be considered *prima facie* evidence of the facts and documents referred to therein.

6.15 Headings. The Article, Section and Subsection entitlements hereof are inserted for convenience of reference only and shall in no way alter, modify, define, limit, amplify or be used in construing the text, scope or intent of such Articles, Sections or Subsections or any provisions hereof.

6.16 Payments. All sums payable under this Guaranty shall be paid in immediately available funds,[143] without offset, in lawful money of the United States of America,[144] which

[142] Generally, time is of the essence when it is expressly made so in a contract, but the benefit of this provision is subject to waiver by Lender's conduct. *See* Hage v. Westgate Square Commercial, 598 S.W.2d 709 (Tex. Civ. App.–Waco 1980, writ ref'd n.r.e.). *See also* annotations to Section 6.9 (No Waiver), *supra*. If time is not of the essence, the performance on the contract is not necessarily required at the agreed upon time for performance. Rather, the parties will be afforded a "reasonable" period of time in which to perform. *See* Moore v. Dilworth, 179 S.W.2d 940, 942 (Tex. 1944). If time is made of the essence, however, a party must perform or tender performance in literal compliance with the terms of the contract or such non-performance would constitute a material breach thereof. *See* Liedeker v. Grossman, 206 S.W.2d 232, 234 (Tex. 1947).

[143] The requirement that funds be "immediately available" curtails Guarantor's ability to tender a check to satisfy a payment obligation imposed by the Guaranty. The general rule is that, unless the parties agree otherwise, payment of an obligation may be made only in money. *See generally* 60 AM. JUR. 2D *Payment* § 32; 11 AM. JUR. 2D *Bills and Notes* § 403; 58 TEX. JUR. 3D *Payment* § 40. "Money" is defined under the Texas Uniform Commercial Code as "a medium of exchange authorized or adopted by a domestic or foreign government and includes a monetary unit of account established by an intergovernmental organization or by agreement between two or more nations." TEX. BUS. & COM. CODE ANN. § 1.201(24) (West 2010); *see also* Clay v. Gage, 20 S.W. 948, 949 (Tex. Civ. App. 1892, no writ) (receipt for a specified bale of cotton, not money). Unless otherwise agreed, a lender is not required to accept a check in payment of an obligation. *See* Fillion v. David Silvers Co., 709 S.W.2d 240, 247 (Tex. App.–Houston [14th Dist.] 1986, writ ref'd n.r.e.) ("in the absence of agreement to the contrary, a check, bill of exchange, or draft does not of itself discharge or constitute payment of a debt, nor does the preparation of such an instrument constitute legal tender"); *see also* Littlejohn v. Johnson, 332 S.W.2d 439, 441 (Tex. Civ. App.–Waco 1960, no writ) ("when money is called for, a check is not valid payment, absent agreement to the contrary"). The

shall at the time of payment be legal tender for the payment of public and private debts.[145] Payments by check or draft shall not constitute payment in immediately available funds until the required amount is actually received by Lender in full.[146]

[*See Rider 4 for Foreign Guarantor Provisions.*]

6.17 Controlling Agreement. It is not the intention of Lender or Guarantor to obligate Guarantor to pay interest in excess of that lawfully permitted to be paid by Guarantor under applicable Law. Should it be determined that any portion of the Guaranteed Obligations or any other amount payable by Guarantor under this Guaranty constitutes interest in excess of the maximum amount of interest that Guarantor, in Guarantor's capacity as guarantor, may lawfully be required to pay under applicable Law, the obligation of Guarantor to pay such interest shall automatically be limited to the payment thereof in the maximum amount so permitted under applicable Law. The provisions of this Section 6.17 shall override and control all other provisions of this Guaranty and any other agreement between Guarantor and Lender.[147]

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specificity of the language of Section 6.16 is intended to put Guarantor on notice as to the exact medium of payment acceptable to Lender.

[144] While foreign currency is generally treated as a commodity in the United States, it may generally serve as a medium of payment only if it has a monetary value in terms of an established rate of exchange. *See* 53A AM. JUR. 2D *Money* § 67. *See also* TEX. BUS. & COM. CODE ANN. § 1.201(24) (West 2010). Subject to this caveat, the parties to a Guaranty may specify the type of currency in which the payment obligations under the Guaranty are to be paid (*i.e.*, the parties are at liberty to specify that a Guaranty be paid in currency other than, or only in, U.S. dollars). The drafter of the Guaranty should, however, be careful to avoid using the term "dollars" without qualifying such term with the type of dollars intended (*e.g.*, U.S., Canadian, or Australian dollars). If a foreign currency is required, the instrument should clearly indicate that only the specified currency is acceptable. These provisions in the Guaranty should also mirror the payment provisions in the Note so as to avoid error or confusion in the amounts and type of payment and currency required.

[145] "Money" and "legal tender" are not necessarily synonymous terms. "Money" is a very broad term, generally encompassing "wealth, capital, property, and anything else that is transferable in commerce." 53A AM. JUR. 2D *Money* § 1; *but see* TEX. BUS. & COM. CODE ANN. § 1.201(24) (West 2010) (providing a more restrictive definition of "money"). "Legal tender," on the other hand, refers to the circulating medium a creditor is compelled by law to accept from a debtor as payment for a debt. 53A AM. JUR. 2D *Money* § 11. Under federal statute, all coins and currencies of the United States, regardless of when coined or issued, are legal tender for all debts, public charges, taxes, and dues. *See* 31 U.S.C. § 5103 (2009). Therefore, payments under the Guaranty are required to be made in "legal tender" to ensure that Guarantor makes payment in a circulating medium acceptable to Lender instead of in a less desirable medium which may be permitted if the Guaranty merely required that payments be made in "money."

[146] This sentence preserves the requirement of immediately available funds while permitting payment by check that may constitute ordinary commercial practice. This provision makes it clear, however, that a remittance constitutes payment only if and when funds are actually received, that is, any provisional credits created by the banking system have become final. This does not change the rules for payment by ordinary check (that payment by check suspends, but does not discharge, the obligation until the check is paid), but may alter the result if payment is by certified or cashier's check. *See* TEX. BUS. & COM. CODE ANN. § 3.310 (West 2010).

[147] As discussed in the annotation to clause (D) in Section 3.1(a)(xv) (Certain Agreements and Additional Waivers by Guarantor), *supra*, a guarantor does not have standing to assert a usury defense that may be available to

6.18 Waiver of Right to Jury Trial. GUARANTOR, TO THE FULLEST EXTENT PERMITTED BY APPLICABLE LAW, HEREBY KNOWINGLY, INTENTIONALLY, IRREVOCABLY, UNCONDITIONALLY AND VOLUNTARILY, WITH AND UPON THE ADVICE OF COMPETENT COUNSEL, WAIVES, RELINQUISHES AND FOREVER FORGOES ALL RIGHT TO A TRIAL BY JURY IN ANY ACTION, SUIT, PROCEEDING, OR COUNTERCLAIM BASED UPON, ARISING OUT OF, OR IN ANY WAY RELATING TO THIS GUARANTY OR ANY OF THE LOAN DOCUMENTS OR ANY CONDUCT, ACT, FAILURE TO ACT OR OMISSION OF OR BY LENDER OR GUARANTOR, OR ANY OF THEIR RESPECTIVE DIRECTORS, OFFICERS, PARTNERS, MEMBERS, EMPLOYEES, AGENTS OR ATTORNEYS, OR ANY OTHER PERSONS AFFILIATED WITH LENDER OR GUARANTOR, IN EACH OF THE FOREGOING CASES, WHETHER SOUNDING IN CONTRACT, TORT OR OTHERWISE, OR IN THE ENFORCEMENT OF ANY OF THE TERMS OR PROVISIONS OF THIS GUARANTY OR THE LOAN DOCUMENTS. IT IS AGREED AND UNDERSTOOD THAT THIS WAIVER CONSTITUTES A WAIVER OF TRIAL BY JURY OF ALL CLAIMS AGAINST ALL PARTIES TO SUCH ACTIONS OR PROCEEDINGS, INCLUDING CLAIMS AGAINST PARTIES WHO ARE NOT PARTIES TO THIS GUARANTY. THIS WAIVER IS KNOWINGLY, WILLINGLY AND VOLUNTARILY MADE BY GUARANTOR, AND GUARANTOR HEREBY REPRESENTS THAT NO REPRESENTATIONS OF FACT OR OPINION HAVE BEEN MADE BY ANY INDIVIDUAL TO INDUCE THIS WAIVER OF TRIAL BY JURY OR TO IN ANY WAY MODIFY OR

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the borrower. A guarantor may, however, be entitled to assert a claim of usury under the guaranty if the guaranty itself (or some other direct contractual arrangement between the lender and the guarantor) imposes separate payment obligations on the guarantor for which the guarantor functions as a direct obligor. *See* Houston Sash & Door Co. v. Heaner, 577 S.W.2d 217, 222 (Tex. 1979); Skeen v. Slavik, 555 S.W.2d 516 (Tex. Civ.App.—Dallas 1977, writ ref'd n.r.e.). Common examples of these types obligations include: (1) an obligation imposed on Guarantor to pay interest accruing on the Guaranteed Obligations at a stated rate from the time a demand is made on the guarantor until such time as the Guaranteed Obligations are paid in full, and (2) as is the case under Section 6.6 (Attorneys' Fees and Costs of Collection) of this Guaranty, *supra*, an obligation imposed on Guarantor to pay certain costs of collection together with interest at the Default Interest Rate. These are direct obligations of Guarantor and are separate from those obligations arising under the Note. Because these amounts could constitute usurious interest, a claim of usury could therefore exist in favor of Guarantor with respect to these amounts. *See* TEX. FIN. CODE ANN. § 301.002(a)(4) (West 2010) for the definition of "interest" under Texas law. Accordingly, in addition to the care that must taken by the lender to avoid a usury violation in the process of underwriting, structuring and documenting the loan, it is critical for the lender to be aware that a usury violation could occur pursuant to the Guaranty itself. It is for this reason, essentially to protect the lender from the consequences of unintended and unanticipated violations of the usury law, that the guaranty should contain what is commonly referred to as a "usury savings clause." For a full discussion of the operation and effect of a usury savings provision and related issues regarding charges and interest, *see* Annotated Promissory Note, Section 4.3 (Interest Provisions). *See also* annotation to clause (D) in Section 3.1(a)(xv) (Certain Agreements and Additional Waivers by Guarantor), *supra*, for a discussion of the inability of a guarantor to assert a usury defense that may be available to the borrower under a note.

Another issue presented by the language in the last sentence in this Section 6.17 is the interpretational hierarchy of conflicting documents. By not including a contractual recitation of the intent of the parties with respect to the interpretational hierarchy of conflicting documents, this Guaranty implicitly contemplates that there will be no other document entered into by and between Guarantor and Lender regarding Guarantor's obligations hereunder. If such additional documents exist or are contemplated to exist, it would be prudent practice to include a contractual provision governing the intent of the parties with respect to such issues. *See* Annotated Promissory Note, Section 4.15 (Controlling Agreement) for a discussion of the interpretation of conflicting loan document provisions and the various rules of interpretation typically observed when construing multiple documents together.

NULLIFY ITS EFFECT. GUARANTOR FURTHER REPRESENTS AND WARRANTS THAT IT HAS BEEN REPRESENTED IN THE SIGNING OF THIS GUARANTY AND IN THE MAKING OF THIS WAIVER BY INDEPENDENT LEGAL COUNSEL, OR HAS HAD THE OPPORTUNITY TO BE REPRESENTED BY INDEPENDENT LEGAL COUNSEL SELECTED OF ITS OWN FREE WILL, AND THAT IT HAS HAD THE OPPORTUNITY TO DISCUSS THIS WAIVER WITH COUNSEL.[148] Neither this provision nor any provision in the Loan Documents regarding waiver of jury trial or submission to jurisdiction or venue in any court is intended or shall be construed to be in derogation of any provision herein or in any Loan Document for arbitration of any controversy or claim.

[*See* Rider 5 *for Arbitration Option.*]

6.19 Entire Agreement. THIS GUARANTY EMBODIES AND CONTAINS THE FINAL, ENTIRE AGREEMENT BETWEEN LENDER AND GUARANTOR WITH RESPECT TO THE GUARANTY BY GUARANTOR OF THE GUARANTEED OBLIGATIONS. THIS GUARANTY SUPERSEDES ALL PRIOR REPRESENTATIONS, WARRANTIES AND AGREEMENTS AND UNDERSTANDINGS, IF ANY, WITH RESPECT TO THE GUARANTY BY GUARANTOR OF THE GUARANTEED OBLIGATIONS. NEITHER

[148] In 2004, the Supreme Court of Texas expressly held that jury waiver provisions are enforceable. In re Prudential Ins. Co. of Am. 148 S.W.3d 124, 130 (Tex. 2004). The court held that such a contractual waiver was neither contrary to the Texas Constitution nor a violation of public policy. *Id*. Rather, the court emphasized the "strong public policy in favor of preserving the freedom of contract" to ensure that the parties' expectations are protected. *Id*.; DeSantis v. Wackenhut Corp., 793 S.W.2d 670, 677 (Tex. 1990).

As early as 1847, the Texas Supreme Court upheld a statute in which the parties to a bond renounced their right to notice and trial by jury. *See* Janes v. Adm'rs of Reynolds, 2 Tex. 250 (Tex. 1847). "[W]hen a party agrees to have a dispute resolved through arbitration rather than a judicial proceeding, that party has waived its right to a jury trial." Massey v. Galvan, 822 S.W.2d 309, 318-19 (Tex. App.—Houston [14th Dist.] 1992, writ denied). The submission of a case to arbitration involves a greater compromise of procedural protection than does the waiver of the right to a jury. *See* Telum, Inc. v. E.F. Hutton Credit Corp., 859 F.2d 835 (10th Cir. 1988) (also holding that general allegations of fraud in the inducement to sign the contract are not sufficient to invalidate a jury waiver provision), cert. denied, 490 U.S. 1021 (1989). *See also* annotations to Rider 5 (Arbitration Option), *infra*. Thus, a "public policy that permits parties to waive trial altogether surely does not forbid waiver of trial by jury." In re Prudential, 148 S.W.3d at 131. Since In re Prudential, Texas Courts of Appeals have recognized and, for the most part, followed the Supreme Court's reasoning. *See e.g.* In re Credit Suisse, 257 S.W.3d 486, 491 (Tex. App.—Houston [14th Dist.] 2008, orig. proceeding [mand. denied]); In re Bank of Am., 278 S.W.3d 342, 344 (Tex. 2009) (directing the court to vacate its opinion in Mikey's Hos. v. Bank of America, 232 S.W.3d 145, 150 (Tex. App.—Fort Worth 2007, no pet.) (holding that there is a presumption against jury waivers)).

Moreover, the Court noted that almost all states have allowed the waiver of a right to trial by jury. *See e.g.*, Rhode Island Depositors Econ. Prot. Corp. v. Coffey & Martinelli, Ltd., 821 A.2d 222, 226 (R.I. 2003); Lowe Enters. Residential Partners, L.P. v. Eighth Judicial Dist. Court, 118 Nev. 92, 40 P.3d 405 (2002); L & R Realty v. Connecticut Nat'l Bank, 246 Conn. 1, 715 A.2d 748, 754-755 (1998); Malan Realty Investors, Inc. v. Harris, 953 S.W.2d 624, 626-627 (Mo. 1997) (en banc) (per curiam); Mall, Inc. v. Robbins, 412 So.2d 1197, 1200 (Ala. 1982). *See also* Annotated Deed of Trust, Section 12.20 (Waiver of Jury Trial) for a detailed discussion of the enforceability of contractual civil jury waiver provisions in various other states and in each federal circuit court. Since In re Prudential, other states have followed its lead. *See e.g.*, Ex Parte AIG Baker Orange Beach Wharf L.L.C., 49 So.3d 1198, 1203 (Ala. 2010); GE Commercial Fin. Bus. Prop. v. Heard, 621 F.Supp.2d 1305 (M.D. Ga. 2009.

PARTY IS RELYING ON ANY REPRESENTATIONS, WARRANTIES OR AGREEMENTS EXCEPT AS CONTAINED IN THIS GUARANTY.[149] NO CONDITION OR CONDITIONS PRECEDENT TO THE EFFECTIVENESS OF THIS GUARANTY EXIST. THIS GUARANTY SHALL BE EFFECTIVE UPON EXECUTION BY GUARANTOR AND DELIVERY TO LENDER. THIS GUARANTY REPRESENTS THE FINAL AGREEMENT BETWEEN THE PARTIES AND MAY NOT BE CONTRADICTED BY EVIDENCE OF PRIOR, CONTEMPORANEOUS OR SUBSEQUENT ORAL AGREEMENTS OF THE PARTIES. THERE ARE NO UNWRITTEN ORAL AGREEMENTS BETWEEN THE PARTIES. THIS GUARANTY MAY BE AMENDED ONLY BY AN INSTRUMENT IN WRITING EXECUTED BY GUARANTOR AND LENDER REFERENCING THIS GUARANTY AND SPECIFICALLY IDENTIFYING THE PROVISIONS HEREOF THAT ARE TO BE AMENDED.[150]

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[149] *See* Italian Cowboy Partners, Ltd., *supra* at 336 (refusing to extend its holding in Schulmberger to a lease where there was no clear, unequivocal and express disclaimer of reliance in a merger clause). The authors believe that the inclusion of this language will satisfy the requirements that the court set forth in this recent case to defeat a fraudulent inducement action.

[150] A written contract is deemed to represent the complete agreement of the parties thereto as to all terms contained in the written contract. *See* Whiddon v. Gen. Mills, Inc., 347 S.W.2d 7, 10 (Tex. Civ. App.–Fort Worth 1969, no writ). Section 6.19 is an attempt to evidence the intent of the parties if any question of merger or integration should arise; such intent being that the parties expressly agreed that all previous and contemporaneous agreements be included in the Guaranty. Such a provision is particularly important in a loan context to avoid any future claim by a guarantor that the guaranty is "inconsistent" with the loan application, loan commitment or loan term sheet. This merger doctrine is closely related to the parol evidence rule, which generally states that extrinsic evidence cannot be admitted to vary or contradict the terms of a written agreement. *See id.*

The Texas Business and Commerce Code codifies the parol evidence rule with regard to loan transactions. *See* TEX. BUS. & COM. CODE ANN. § 26.02 (West 2010). Any "loan agreement" (as such term is defined therein) executed in connection with a loan in excess of $50,000 must be in writing and signed by the party to be bound (debtor or obligor) or such loan agreement will be unenforceable. Furthermore, no agreement subject to section 26.02 may be varied by any oral agreements or discussions that occurred prior to or contemporaneously with the execution thereof, and section 26.02(e) sets out the language that must be contained in the written notice notifying all parties of such fact. *See id.* The scope of the statute's protection essentially covers state or federal banks, savings and loans, credit unions or HUD approved lenders. *See id.* The notice must be conspicuous and the notice language must substantially state: "This written loan agreement represents the final agreement between the parties and may not be contradicted by evidence of prior, contemporaneous or subsequent oral agreements of the parties. There are no unwritten oral agreements between the parties." *See id.*

Section 6.19 is a way of "bootstrapping" the notice of final agreement, as such is typically set out in a separate document. **And while section 26.02 is unclear whether it applies to a guaranty (and there appears to be no Texas case directly on point addressing this issue)**, it is a prudent practice to include the notice in the guaranty, as well as in all other loan documents executed by the guarantor or the borrower which could be construed as a "loan agreement" under section 26.02. *See generally,* Todd C. Pearson, Limiting Lender Liability: the Trend Towards Written Credit Agreement Statutes, 76 MNLR 295 (December 1991) (noting that certain states have expanded their list of documents which fall outside of such statutes, and specifically noting that Kansas has exempted guaranties). Although outside the scope of this annotation, it should be noted that notwithstanding the above, extrinsic evidence may be admitted in certain limited circumstances to show the following: nonexistence of an agreement, incapacity, fraud, undue influence, mutual mistake, failure of consideration, agreements contrary to public policy or public morals or illegality. *See also* Annotated Promissory Note, annotations to Section 4.22 (Entire Agreement) for a discussion of this notice with respect to a Note and Borrower.

[See Rider 6 for Form of Guarantor Consent.]

[See Rider 7 for Exclusion of Certain Guarantor Assets.]

[*Definitions contained in any Rider should be incorporated into Section 1.1 hereof when included in the body of this Guaranty*]

[Signatures appear on the following page(s)]

IN WITNESS WHEREOF, Guarantor duly executed this Guaranty as of the date first written above.

Address of Guarantor:[151]

____
____
____
____
Fax No. ________________________
Telephone No. ___________________

GUARANTOR:[152]

____,
a ____

[Set up signature block for applicable individual or entity]

[151] It is critical for the lender to obtain the correct address for the guarantor. Sending notices to an incorrect address could raise questions as to whether the notices were effective. If the address included is not correct, sending notices to the incorrect address may be legally sufficient notice under the Guaranty, but such notices will not advance the purpose of reaching the intended recipient. Further, Lender and the drafter of the Loan Documents should confirm that the address for Guarantor under the Guaranty and each applicable Loan Document (and that the address for each party under each of the Loan Documents) is exactly the same (*e.g.*, each comma, period and abbreviation) to avoid having to send multiple notices under multiple loan documents when the giving of notice is required.

[152] A forged signature is generally ineffective against a guarantor. *See* Dodd v. Harper, 670 S.W.2d 646, 647-48 (Tex. App.–Houston [1st Dist.] 1983, no writ). However, a forged signature may be retroactively adopted by the statements or actions of a guarantor. *See* Stout v. Oliveira, 153 S.W.2d 590, 596 (Tex. Civ. App.–El Paso 1941, writ ref'd w.o.m.). Further, if a person signs the name of another with authority to do so, the signature is not a forgery. *See* In re Barber, 982 S.W.2d 364, 366 (Tex. 1998). Such authority may take the form of actual or apparent authority. *See* Ginsberg 1985 Real Estate P'ship v. Cadle Co., 39 F.3d 528, 536 (5th Cir. 1994). It has long been established that the burden of proving that the signature is not genuine rests with Guarantor. *See* Kraker v. Bettman-Klienhauser Clothing Co., 12 S.W.2d 247 (Tex. Civ. App.–San Antonio 1928, no writ). The issue of whether the allegedly forged signature is genuine, including the credibility of any witnesses, is within the province of the fact finder. *See* Lenamond v. N. Shore Supply Co., 667 S.W.2d 283, 286 (Tex. App.–Houston [14th Dist.] 1984, no writ). *See also* annotation to Paragraph C. in the Recitals to this Guaranty, *supra*, and annotations to Sections 4.1(b) and (d) (Representations and Warranties of Guarantor), *supra*.

[Joinder of Spouse][153]

Address of Lender:

____

____
____
____
____
Fax No.:__________________________
Telephone No. ______________________

[153] A guarantor may contractually bind the guarantor's separate property, the guarantor's sole management community property, and the joint management community property of the guarantor and the guarantor's spouse. However, the guarantor cannot contractually bind the separate property and sole management community property of the guarantor's spouse without the spouse's consent. *See* TEX. FAM. CODE ANN. §3.202 (West 2010). Although Section 3.102 of the Texas Family Code delineates the assets which are presumed to be the guarantor's sole management community property, the recommended course of action is to specifically address the characterization of property in the Guaranty itself. In particular, lenders should consider having the spouse sign the guaranty as a guarantor. If the guarantor's spouse is unwilling to sign as a guarantor, lenders should specifically identify the assets subject to and excluded from the Guaranty, and obtain the consent of the guarantor's spouse to the Guaranty. The spouse's consent is generally sufficient to bind the spouse's assets. *See* Serv. Parts Co. v. Bizzell, 120 S.W.2d 919 (Tex. Civ. App.–Eastland 1938, no writ); Waggoner Bank & Trust Co. v. Warran, 152 S.W. 691 (Tex. Civ. App.–Texarkana 1912, no writ); Therriault v. Compere, 47 S.W. 750 (Tex. Civ. App. 1898, no writ). *Cf.* first annotation to Rider 7 (Exclusion of Certain Guarantor Assets), *infra*. Lenders should carefully consider in its underwriting process which assets of the guarantor and his or her spouse are being included in calculating the guarantor's financial strength.

STATE OF TEXAS § [154]
§
COUNTY OF __________ §

This instrument was ACKNOWLEDGED before me on _______________, 20___ by _________________________________. **[CONFORM TO INDIVIDUAL OR ENTITY]**

[S E A L] ____
Notary Public, State of Texas

My Commission Expires:
____________________ ____
Printed Name of Notary Public

Schedule of Riders:

Rider 1 - Limitations of Guaranteed Indebtedness
Rider 2 - Additional Construction Loan Performance Obligations
Rider 3 - Specific Financial Covenants
Rider 4 - Foreign Guarantor Provisions
Rider 5 - Arbitration Option
Rider 6 - Form of Guarantor Consent
Rider 7 - Exclusion of Certain Guarantor Assets

[154] Neither the acknowledgment nor the recording of the Guaranty is necessary to make the instrument valid as between the guarantor and the lender. An acknowledgment, however, causes the Guaranty to be self-authenticated in the event of a suit on the Guaranty. *See* TEX. R. EVID. 902(8). Extrinsic evidence of authenticity as a condition precedent to admissibility is not required when the Guaranty has been acknowledged.

Accordingly, although not required under Texas law, some lenders require as a matter of policy that a the guarantor's execution of a Guaranty be acknowledged by a notary public for evidentiary purposes, a practice which has become increasingly common as the execution of a Guaranty typically occurs outside of the presence of the loan officer and the lender's attorney.

Within the State of Texas, an acknowledgment may be taken by the clerk of a district court, a judge or clerk of a county court, or a notary public. *See* TEX. CIV. PRAC. & REM. CODE ANN. § 121.001 (West 2010). Outside the State of Texas, but within the United States or U.S. territories, an acknowledgment may be taken by a clerk of a court of record having a seal or a notary public; the official seal of the notary public must be affixed to the instrument only if the jurisdiction in which certificate is made requires the notary to do so. *See id.* § 121.004(c); *see also* Steven Calens Haley, Texas Law of Acknowledgments, 30th ANNUAL MORTGAGE LENDING INSTITUTE (1996); James Noble Johnson, Acknowledgments, STATE BAR OF TEXAS ADVANCED REAL ESTATE DRAFTING COURSE (1993).

Rider 1

LIMITATIONS OF GUARANTEED INDEBTEDNESS[155]

[155] Each of the examples in this Rider 1 limit the Guaranteed Obligations of Guarantor. Texas case law is instructive when drafting the provisions intended to limit the obligations of the guarantor. The most important consideration in the preparation of such provisions is, as in drafting any document, clarity. If the provision limiting the guaranteed amount is less than crystal clear, the guarantor will more likely than not, in a suit to enforce the Guaranty, assert that the Guaranty is ambiguous. In such a circumstance, the courts in Texas will apply the "cardinal rule" applicable to the construction of all contracts that "[i]n construing a written contract, the primary concern of the court is to ascertain the true intentions of the parties as expressed in the instrument." Preston Ridge Fin. Serv. Corp. v. Tyler, 796 S.W.2d 772, 775 (Tex. App.–Dallas 1990, writ denied); *see also* Coker v. Coker, 650 S.W.2d 391, 393 (Tex. 1983). It is therefore important to look at reported decisions to determine what the courts will look for in the Guaranty in order to determine the intentions of the parties. In both Preston Ridge and University Sav. Ass'n v. Miller, 786 S.W.2d 461 (Tex. App.–Houston [14th Dist.] 1990, writ denied), the courts construed a guaranty of part, but not all, of a borrower's indebtedness. Each court stressed that a court must examine the entire writing "in an effort to harmonize and give effect to all the provisions of the contract" and that a court must "strictly construe a guaranty according to its precise terms and not extend by construction the guarantor's obligations." Preston Ridge, 796 S.W.2d at 775; University Sav., 786 S.W.2d at 462-63. A guarantor's obligation should not be extended by construction or implication beyond the precise terms of the guaranty. In Preston Ridge, the guarantor executed a guaranty for the amount by which the outstanding principal balance exceeded $735,000. The guarantor claimed that a foreclosure which reduced the debt to $368,555.99 extinguished the guaranty. The Preston Ridge court looked at the inducement language and the guarantor's agreement to pay and held that the liability of the guarantor attached at the time of acceleration of the debt. In University Savings, the guarantor had executed a guaranty that provided that "at such time as the principal... has been reduced by $274,000 or more, this guaranty shall automatically terminate and be of no further force and effect." 786 S.W.2d at 462. University Savings accelerated the debt, foreclosed on the property, and applied foreclosure proceeds in excess of $274,000 to the unpaid principal amount of the debt. The University Savings court found that proper demand had been made and that exercise of remedies by University Savings was discretionary and therefore the foreclosure did not impair the guaranty. Although the Texas Supreme Court apparently has not dealt with a case involving a partial guaranty, it would appear that courts, in construing guarantees, will look at all the provisions of the guaranty in each case and strive to enforce the guaranty even in the face of the long-standing rule against increasing the guarantor's obligations.

Courts in the following states have also faced the issue of reduction of guaranteed indebtedness in a limited guaranty context with proceeds of a foreclosure sale, and all but Virginia have decided in favor of the lender. **Arizona**: Tenet Healthcare System Inc. v. Silver, 52 P.3d 786 (App. 2002) (guaranteed obligations diminished by foreclosure sale proceeds). **Arkansas**: Lindell Square Ltd. P'ship v. Savers Fed. Sav. & Loan Ass'n, 766 S.W.2d 41 (Ark. Ct. App. 1989) (proceeds of foreclosure should not be allowed to reduce guaranteed obligation); **Florida**: MacCulley v. Fidelity Fed. Sav. & Loan Ass'n, 335 So.2d 327 (Fla. Dist. Ct. App. 1976) (guaranteed obligation not reduced by foreclosure proceeds, but only by payments received in the ordinary course of business); **Illinois**: Telegraph Sav. & Loan Ass'n v. Guar. Bank & Trust Co., 385 N.E.2d 97, 102 (Ill. App. Ct. 1978) ("applying the foreclosure sale proceeds as payments on the loan would render the guaranty taken as additional security illusory and meaningless"); **Massachusetts**: Sec. Co-op. Bank v. Corcoran, 10 N.E.2d 57, 58 (Mass. 1937) ("When before the foreclosure, the entire balance of the note became due, the guarantor became liable for that amount."); **New York**: Alpha Fin. Assocs. v. Dann, 186 S.2d 554, 557-59 (N.Y. Sup. Ct. 1959), *aff'd*, 188 S.2d 956 (N.Y. App. Div. 1959) ("payment from foreclosure proceeds was payment made from property itself ... and cannot be considered a payment ... within the meaning of the guarantee...."); **South Carolina**: Williams v. Teran, Inc., 221 S.E.2d 526 (S.C. 1976) (reduction in note amount could only occur by voluntary payments); **Virginia**: Grob v. B.F. Saul Real Estate Inv. Trust, 294 S.E.2d 859 (Va. 1982) (notwithstanding fact that lender sued guarantor and reduced its claim to judgment prior to foreclosure, court held that foreclosure proceeds reduced the guaranteed indebtedness); and **Wisconsin**: Crown Life Ins. Co. v. LaBonte, 330 N.W.2d 201 (Wis. 1983) (guaranty provides "additional security" for the debt and only voluntary payments reduce guaranteed obligation; proceeds from foreclosure do not constitute "due and punctual payment").

Example 1 ***(Up-front Limitation on liability for principal amount)*****:**[156]

Section 1.1, Definitions. The following definition should be added:

> **[Guaranteed Principal: An amount equal to [________ percent (___%) of the stated principal amount of the Note (for a maximum guaranteed principal amount of $_______________)] [__________ percent (_____%) of the principal balance of the Note outstanding from time to time]]**.[157]

Section 2.1, Guaranty of Payment: Insert the following paragraph at the end of Section 2.1.

[Notwithstanding anything to the contrary set forth herein, Guarantor shall be fully and personally liable and subject to legal action for the following: (i) only the Guaranteed Principal with respect to the principal amount of the Loan; plus (ii) any and all accrued but unpaid interest on the Note; plus (iii) any and all attorneys' fees and costs of collection incurred by or on behalf of Lender pursuant to Section 6.6 of this Guaranty; plus (iv) all other sums (other than the principal amount of the Loan in excess of the Guaranteed Principal) included as Guaranteed Indebtedness as set forth in Section 1.1 above and for all of the other Guaranteed Obligations in accordance with the terms of this Guaranty. This limitation of liability with respect to the principal amount of the Note, however, shall in no way affect, diminish or limit the other obligations of Guarantor under this Guaranty or the obligations of Borrower under the Note or any of the other Loan Documents.]

Example 2 ***(Liable for only the "Top" __% of principal)*****:**[158]

Section 1.1, Definitions. The following definition should be added:

[156] A common limitation is based upon liability for a stated dollar amount or a specific percentage of the indebtedness evidenced by the Note. Care should be taken in specifying the effect of principal payments on such liability and defining the percentage parameters (*i.e.*, whether the percentage is applied to the current outstanding balance or to the stated principal amount of the Note).

[157] The definition of "Guaranteed Principal" could apply to either a certain percentage of the stated principal amount of the Note or a percentage of the principal balance of the Note outstanding from time to time. A percentage of the stated principal amount of the Note creates a fixed amount of Guaranteed Principal, while a percentage of the principal balance of the Note outstanding from time to time creates a floating amount of Guaranteed Principal. The amount of Guaranteed Principal, whether fixed or floating, should be clearly defined and understood as between Lender and Guarantor and in the Guaranty to avoid any confusion or conflict in the future as to the amount actually guaranteed.

[158] Example 2 presents (as do Examples 1 and 3 in this Rider 1) a calculation issue for Guarantor and Lender in that care must be taken in calculating the amount for which Guarantor is liable, such as, in this Example 2, the "top ___%" of the principal amount of the Note. The principal balance of the Note could increase as a result of a default or as a result of additional advances made by the lender. Therefore, as a practical matter, the parties must be careful in documenting exactly when the "top ___%" of principal is repaid. This example could be revised to provide that Guarantor's liability for the "top ___%" would "resurrect" if the outstanding principal balance at some time in the future increased above the "top ___%" threshold.

[Guaranteed Principal: An amount equal to ________ percent (___%) of the stated principal amount of the Note (for a maximum guaranteed principal amount of $_______________).]

Section 2.1, Guaranty of Payment: Insert the following paragraph at the end of Section 2.1.

[Notwithstanding anything to the contrary set forth herein, Guarantor shall be fully and personally liable and subject to legal action for the following: (i) only the Guaranteed Principal with respect to the principal amount of the Loan, provided that once an amount of principal equal to the Guaranteed Principal has been paid in full, then Guarantor shall have no further liability for the repayment of principal under the Note; plus (ii) any and all accrued but unpaid interest on the Note; plus (iii) any and all attorneys' fees and costs of collection incurred by or on behalf of Lender pursuant to Section 6.6 of this Guaranty; plus (iv) all other sums (other than the principal amount of the Loan in excess of the Guaranteed Principal) included as Guaranteed Indebtedness as set forth in Section 1.1 above and for all of the other Guaranteed Obligations in accordance with the terms of this Guaranty. This limitation of liability with respect to the principal amount of the Note, however, shall in no way affect, diminish or limit the other obligations of Guarantor under this Guaranty or the obligations of Borrower under the Note or any of the other Loan Documents.]

Example 3 *(Sample of a "Springing" Non-Recourse or Limited Recourse Provision)*:[159]

Section 1.1, Definitions. The following definitions should be added (or incorporated into the Guaranty by reference to the Note, the Deed of Trust or the Loan Agreement, as applicable):

[Debt Coverage Ratio:[160] The ratio of (i) Net Operating Income from the Mortgaged Property for any calendar month in question, as verified to Lender's sole

[159] Another common type of limitation on the guarantor's liability, sometimes referred to as "start-up liability," imposes liability on the guarantor for the full amount of the indebtedness until such time as the mortgaged property has achieved certain occupancy or net operating income levels. This option provides a lender with additional comfort and security during the start-up phase of the mortgaged property until specified criteria have been met, and permits a reduction in the guarantor's liability only upon the lender's satisfaction that the income from the mortgaged property will be sufficient to support operating expenses and debt service later in the term of the loan.

[160] Many lenders will require, as a condition to reducing the guarantor's liability for repayment of the Guaranteed Indebtedness, that the mortgaged property generate sufficient net operating income to cover the debt service on the Loan (*i.e.*, the payments of principal and interest on the Note as such payments become due). For example, the lender may require that the mortgaged property maintain a Debt Coverage Ratio of at least 1.20 to 1.00 (*i.e.*, net operating income of at least 120% of the amount of the debt service payments as such payments become due) for a specified period of time (such as six consecutive months) before allowing a reduction in the guarantor's liability on repayment of the indebtedness. Lenders and guarantors should carefully review these definitions and consider the consequences of each.

The following is a common variation of this definition: "Debt Coverage Ratio: the ratio calculated by dividing the Net Operating Income by the Target Monthly Amortization on an annualized basis. For purposes hereof, the term "Target Monthly Amortization" means the hypothetical monthly payment of principal and interest which would be required for each month during the term of the Note assuming an amortization of the outstanding principal balance of the Note in level payments of principal and interest over a period of 30 years, at an interest rate

satisfaction, to (ii) the greater of (A) the amount of principal and interest that would be due monthly on a promissory note with an outstanding principal balance equal to the outstanding principal balance of the Note and an obligation of Borrower to pay equal monthly installments of principal and interest calculated by amortizing the outstanding principal balance of the Note over 30 years at a rate of interest equal to the higher of (1) _________ percent (__%) per annum, (2) the per annum rate equal to the sum of the Treasury Constant Maturity Yield Index plus _________ percent (__%) or (3) the rate of interest then actually accruing on the Note or (B) the actual regularly scheduled debt service payment(s) of principal and interest due under the Note for the calendar month in question.]

[Gross Income:[161] For the applicable annual period, all rentals, revenues, income and other recurring forms of consideration, received by, or paid to or for the account of or for the benefit of, Borrower resulting from or attributable to the operation, leasing and occupancy of the Mortgaged Property determined on a cash basis (except as specifically provided in the Loan Documents to the contrary) and using for all calculations hereunder the greater of (x) the actual vacancy rate of the Mortgaged Property at the time of such calculation or (y) an applied vacancy factor of _________ percent (__%); the term "Gross Income" as used hereunder shall include, without limitation, the following:

(i) rents actually paid by any tenants or occupants of all or any portion of the Mortgaged Property;

(ii) proceeds actually received by, for the account of or on behalf of Borrower in connection with any rental loss or business interruption insurance with respect to the Mortgaged Property;

(iii) any other fees or rents actually collected by, for the account of or on behalf of Borrower with respect to the leasing and operation of the Mortgaged Property; and

(iv) any interest earned by Borrower on security deposits and other types of deposits or advance rentals paid by any tenants or occupants of all or any portion of the Mortgaged Property.

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per annum equal to the greater of (a) ____ percent (__%) per annum, (b) the per annum rate equal to the sum of the Treasury Constant Maturity Yield Index plus ____ percent (__%), or (c) the per annum rate of interest then actually accruing on the Note."

[161] Although this list of inclusions and exclusions from Gross Income is relatively common, such definition may need to be modified given the character of the Mortgaged Property (whether retail, restaurant, office, multi-family or hotel) and is often subject to heavy negotiation based upon the manner in which Borrower operates its business and the accounting methods utilized by Borrower in determining gross income from the Mortgaged Property. Lender should, however, maintain approval rights as to the method of calculation and the items included and excluded from such calculation, as these issues may have a significant impact on the rights and obligations of Borrower and Guarantor under the Loan Documents.

Notwithstanding anything included within the foregoing definition of Gross Income, there shall be excluded from Gross Income the following: (1) any security deposits or other types of deposits or advance rentals paid by tenants and occupants of all or any portion of the Mortgaged Property (even when applied to sums due under leases), (2) rents and receipts received by, for the account of or on behalf of Borrower to the extent applicable to services provided by Borrower for the benefit of tenants or occupants, (3) the proceeds of any financing or refinancing with respect to all or any portion of the Mortgaged Property, whether or not same has been previously approved by Lender, (4) the proceeds of any sale or other capital transaction (excluding leases made for occupancy purposes only) of all or any portion of the Mortgaged Property, whether or not same has been previously approved by Lender, (5) any insurance or condemnation proceeds paid with respect to the Mortgaged Property to the extent such proceeds are used to restore or rebuild the Mortgaged Property as may be provided under Section ____ of the Deed of Trust (except for rental loss or business interruption insurance as specifically provided above), (6) any insurance and condemnation proceeds applied in reduction of the outstanding principal balance hereof as may be provided under Section ____ of the Deed of Trust, and (7) the application of any sums on deposit with Lender in the reduction of the outstanding principal balance of the Note as may be provided under the Note or the other Loan Documents and any interest earned on such sums; provided, however, nothing set forth herein shall in any manner imply Lender's consent to any sale, refinancing, disposition or other capital transaction relative to or affecting all or any portion of the Mortgaged Property.]

[<u>Net Operating Income</u>:[162] All Gross Income for the applicable annual period less all Operating Expenses for such corresponding annual period, as determined or approved by Lender in Lender's sole discretion.]

[<u>Operating Expenses</u>:[163] For the applicable annual period, an amount equal to the greater of (x) the product of the number of [units contained on the Mortgaged Property] [gross leasable square feet contained in the Mortgaged Property] <u>multiplied by</u> $__________, or (y) the reasonable costs and expenses actually

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[162] Net Operating Income from the mortgaged property should be determined by the lender from information contained in the periodic (whether monthly, quarterly or annual) operating and income statements pertaining to the mortgaged property and other financial statements provided to the lender in connection with the reporting covenants under the loan documents. *See* <u>Annotated Deed of Trust</u>, Sections 4.9 (Property Reports) and 4.10 (Financial Reporting). All such financial or performance information should be required to be certified to in writing by the borrower as being true, accurate and complete so that any rights relinquished by the lender in connection with achievement of a specified level of net operating income based upon false or inaccurate information will give rise to the lender's remedies under the loan documents for violation of the representations and warranties default provision under the deed of trust. *See* <u>Annotated Deed of Trust</u>, Sections 3.3 (Accuracy of Information) and 6.2 (Performance of Obligations).

[163] This list of inclusions of and exclusions from Operating Expenses are relatively common, but like the definition of "Gross Income," are often modified based upon the character of the Mortgaged Property and the accounting methods utilized by Borrower (which must be acceptable to Lender).

incurred and paid by Borrower with respect to the ownership, operation, management, leasing and occupancy of the Mortgaged Property determined on a cash basis (except where accrual basis is required hereunder) including, without limitation, any and all of the following (but without duplication of any item):

(i) ad valorem taxes calculated on an accrual basis (and not on a cash basis) of accounting for the applicable annual period; such accrual accounting for ad valorem taxes shall be based upon taxes actually assessed for the current applicable annual period, or if such assessment for the current applicable annual period has not been made, then until such assessment has been made (and with any retroactive adjustments for prior calendar months as may ultimately be needed when the actual assessments have been made), ad valorem taxes for the applicable annual period shall be estimated to be an amount equal to one hundred five percent (105%) of the assessment for the immediately preceding annual period;

(ii) foreign, U.S., state, municipal and local sales, excise, tourism, use or other similar taxes (but not including taxes measured by net income);

(iii) special assessments or similar charges imposed or assessed against all or any portion of the Mortgaged Property;

(iv) costs of utilities, HVAC services, and similar services for the Mortgaged Property to the extent not paid by or chargeable to tenants or occupants of the Mortgaged Property;

(v) maintenance and repair costs for the Mortgaged Property, including the replenishment of any reserve account for maintenance and repair established pursuant to the Loan Documents and assuming a minimum annual capital expenditure of [$_____ per unit contained in the Mortgaged Property] [$________ per square foot of gross leasable area in the Mortgaged Property];

(vi) the greater of the actual management fees under any property management agreement for the Mortgaged Property or an applied annual management fee of _____ percent (__%) of the annual Gross Income of the Mortgaged Property;

(vii) all salaries, wages and other benefits paid to employees of Borrower or Borrower's property manager (excluding all salaries, wages and other benefits paid to officers and supervisory personnel, and other general overhead expenses of Borrower and Borrower's property manager) employed in connection with the leasing, maintenance operation and management of the Mortgaged Property;

(viii) insurance premiums calculated on an accrual basis (and not on a cash basis) of accounting for the applicable annual period; such accrual

accounting for insurance premiums shall be based upon the insurance premiums for the Mortgaged Property for the current applicable annual period which was last billed to Borrower, adjusted to an annualized premium if necessary, and multiplied by one hundred and five percent (105%);

(ix) costs and expenses (including leasing commissions, advertising and promotion costs, even if in excess of a reasonable and necessary amount for same) incurred in obtaining new leases or to extend, expand or renew existing leases, and the cost of work performed and materials provided to cause any tenant space in the Mortgaged Property to be "rent ready" for new or renewal occupancy under leases;

(x) third-party accounting and audit fees and costs and administrative expenses incurred by Borrower in connection with the leasing, maintenance, operation and management of the Mortgaged Property;

(xi) any payments, and any related interest thereon, to tenants or occupants with respect to security deposits or other deposits required to be paid to tenants, but only to the extent any such security deposits and related interest thereon have been previously included in Gross Income; and

(xii) to the extent not included in any other Operating Expense category, the sums paid (or, if not paid, which should have been paid in accordance with the Loan Documents) by Borrower into any reserve account for the applicable annual period in accordance with the Loan Documents.

Notwithstanding anything to the contrary as being included in the definition of Operating Expenses, there shall be excluded from Operating Expenses the following: (1) any depreciation and other non-cash deductions allowed to or taken by Borrower for income tax purposes, (2) all salaries, wages and other benefits paid to "off-site" employees of and all other general "off-site" overhead expenses incurred by Borrower, Borrower's property manager or any other professional manager of the Mortgaged Property, except to the extent related to the leasing, maintenance, operation and management of the Mortgaged Property, (3) any and all payments of ad valorem taxes for either real or personal property (except for the accrual included under item (i) above), (4) the initial funding of any reserve account and any subsequent replenishment thereof (except for amounts included under item (v) above), (5) any and all payments of insurance premiums (except for the accrual amount included under item (viii) above), (6) any and all principal, interest or other costs paid under or with respect to the Loan evidenced by the Note and by the other Loan Documents, and (7) capital improvements to the Mortgaged Property (only to the extent not paid from any reserve account).][164]

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[164] Although beyond the scope of this Guaranty, note that if a certain Debt Coverage Ratio is not satisfied within a specified period of time, the lender may require the borrower to deposit additional funds into a separate

[Treasury Constant Maturity Yield Index: The average yield for "This Week" as reported by the Federal Reserve Board in Federal Reserve Statistical Release H.15 (519). If there is no Treasury Constant Maturity Yield Index for instruments having a maturity coterminous with the remaining term of the Note, then the index shall be equal to the weighted average yield to maturity of the Treasury Constant Maturity Yield Indices with maturities next longer and shorter than such remaining average life to maturity, calculated by averaging (and rounding upward to the nearest whole multiple of 1/100 of 1% per annum, if the average is not such a multiple) the yields of the relevant Treasury Constant Maturity Yield indices (rounded, if necessary, to the nearest 1/100 of 1% with any figure of 1/200 of 1% or above rounded upward).][165]

Section 2.1, Guaranty of Payment: Insert the following paragraph at the end of Section 2.1.

[Notwithstanding anything to the contrary set forth herein, provided that (i) the Mortgaged Property has achieved and maintained for a period of ____ (__) consecutive months a Debt Coverage Ratio of at least ____ to 1.0, (ii) there shall not exist any Default, nor any condition or state of facts which after the passage of time or the delivery of notice or both would constitute a Default[,][and] (iii) no Material Adverse Change shall have occurred in the financial condition of Borrower, Guarantor or any other guarantor of the Loan, or with respect to the Mortgaged Property[, and (iv)][*include any additional conditions as may be required by Lender,*], all as determined by Lender in its [sole] [reasonable] discretion,[166] then [Guarantor's liability under this Guaranty for repayment

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cash collateral account subject to a security interest in favor of the lender so that adequate funds have been set aside to repay the indebtedness if the mortgaged property continues its poor performance. If required by the lender, such a provision is typically included in the Loan Agreement or in the Deed of Trust. *See* Annotated Promissory Note, Footnote 158, for a more detailed explanation of cash collateral accounts.

[165] This interest rate is equal to the rate of United States Treasury obligations with a maturity equal to the remaining term of the Note. If there is not an identically matching term, then the rate is calculated utilizing the average of the next longer and shorter maturities. The utilization of an interest rate accruing on a loan made to the United States at the discount rate obviously leads to a substantially different result than if the interest rate in a private loan transaction was used.

[166] As previously noted, the language in Example 3 can be used either to reduce or entirely release Guarantor's liability for the outstanding principal balance of the Note upon satisfaction of the "burn off" conditions. The conditions precedent for liability "burn off" are typically the subject of extensive negotiations. For example, it is often critical to the lender that the condition under part (ii) of this paragraph include circumstances which would constitute a Default after the passage of time or the giving of notice or both, while Guarantor may view this condition as effectively preventing the reduction in liability from ever occurring. In addition to negotiating the business points related to such conditions precedent (such as the required level and method of calculating the Debt Coverage Ratio), both parties can expect heavy negotiation of the standard of discretion the lender may use in determining whether or not the conditions have been satisfied. To allow maximum flexibility, the lender will prefer the "sole discretion" standard, while the guarantor will prefer a "reasonable" standard to impose some measure of objectivity on the lender's decisions and to provide an opportunity for the guarantor to contest the lender's decision if the lender determines that the conditions have not been satisfied. In addition to the conditions listed above, a lender will often require (i) achievement of specified leasing levels, or (ii) the achievement of a certain loan-to-value ratio based upon the then outstanding principal balance of the loan and upon the value of the mortgaged property as

of principal due under the Note shall be reduced to ____ percent (___%) of the stated principal amount of the Note] [Guarantor shall no longer be liable for repayment of [any principal due under the Note] [any principal or interest due under the Note]]; provided, however, that Guarantor shall remain fully liable for all [interest], taxes, legal fees, collection costs and all other sums (other than principal [and interest]) included as Guaranteed Indebtedness as set forth in Section 1.1 above and for all of the other Guaranteed Obligations in accordance with the terms of this Guaranty. This limitation of liability, however, shall in no way affect, diminish or limit the other obligations of Guarantor under this Guaranty or the obligations of Borrower under the Note or the other Loan Documents.][167]

Example 4 ***(The Loan is non-recourse, but Guarantor is liable for certain "bad-boy" acts):***[168]

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shown in an updated appraisal. *See also* final annotation to this Rider 1 (Limitations of Guaranteed Indebtedness), *infra*.

[167] The alternative language provided in this paragraph may be used either to reduce the amount of principal for which Guarantor is liable, or to eliminate the amount of principal (or principal and interest) for which Guarantor is liable, upon achievement of certain criteria. In either event, such a provision exculpating Guarantor (either in whole or in part) from liability should clearly specify (i) the conditions or criteria which must be achieved for such exculpation to occur, (ii) the principal amount for which Guarantor will thereafter remain liable (such as ___% of the stated principal amount of the Note, or none at all), and (iii) all other costs and expenses for which Guarantor will remain liable (which often includes interest on the Note even when Guarantor is released from liability for the payment of principal). In structuring such a liability "burn-off" provision, Lender and Guarantor should be aware that (a) the principal amount of the Note could increase over the term of the Loan if additional sums are advanced and added to the original principal balance of the Note, (b) the entirety of the principal for which Guarantor is liable could be reduced to zero, yet Guarantor could remain liable for any unpaid interest accruing on the principal, and (c) any limitation on liability relating to principal (or to principal and interest) should not limit Guarantor's liability for satisfaction of the other Guaranteed Obligations. The Guaranty should be clear in stating exactly what Guarantor remains liable for, and should expressly provide that a reduction in Guarantor's liability for principal (or for principal and interest, as the lender may allow) does not limit Guarantor's continued liability for other sums constituting the Guaranteed Indebtedness. Disputes may arise between the lender and Guarantor in this context, so the lender should be very careful in preparing its loan commitment, and the lender's counsel should likewise be very careful in drafting the Guaranty and the other Loan Documents, to be clear and specific as to the items and amounts for which Guarantor remains liable. *See also* first annotation to this Rider 1 (Limitations of Guaranteed Indebtedness), *supra*, for a general discussion on the importance of clarity in a Guaranty.

[168] Example 4 presents an alternative typically used by many "conduit" lenders making permanent or "semi-perm" loans on improved real property, which loans are to be securitized in the capital markets. As the "conduit" market re-emerges, the structure of the carve outs are expanding both as to liability and indemnity. There is an increased focus on liability and indemnification obligations for losses or claims resulting from any expense that the originating lender may face in the securitization or pooling process, and the lenders are requiring guarantors to either be (i) individuals with substantial net worth/liquidity, some of whom are subject to minimum net worth/liquidity requirements if there are concerns about their exposure on other financings or their ability to satisfy these contingent liabilities; and/or (ii) well capitalized entities, all of whom are subject to minimum net worth/liquidity requirements; in some cases, have "back stop" or "cut-through" guarantors whose liability springs into play if the entity fails to satisfy the minimum net worth/liquidity requirements. Further, many of the CMBS loans require two (2) or more guarantors with joint and several liability unless the borrower is truly controlled by one individual. Many of these types of loans are "non-recourse" as against the borrower, except for certain standard "non-recourse carve-outs," such as fraud, absconding with or misapplication of insurance proceeds or condemnation awards, environmental contamination, or intentional waste or damage to the mortgaged property. These are commonly referred to as "bad

Section 1.1, Definitions. The definition of "Guaranteed Indebtedness" should refer solely to the Guaranteed Obligations, and the definition of "Guaranteed Obligations" should be modified, as follows:

[Guaranteed Obligations: As identified in Section 2.1 of this Guaranty.]

Section 2.1, Guaranty of Payment. Replace the provisions of this Section with the following:

[2.1 **Guaranty of Certain Costs. GUARANTOR HEREBY ASSUMES LIABILITY FOR, HEREBY GUARANTEES PAYMENT TO LENDER OF, HEREBY AGREES TO PAY, PROTECT, DEFEND AND SAVE LENDER HARMLESS FROM AND AGAINST, AND HEREBY INDEMNIFIES LENDER FROM AND AGAINST ANY AND ALL LIABILITIES, OBLIGATIONS, LOSSES, DAMAGES, COSTS AND EXPENSES (INCLUDING, WITHOUT LIMITATION, ATTORNEYS' FEES), CAUSES OF ACTION, SUITS, CLAIMS, DEMANDS AND JUDGMENTS OF ANY NATURE OR DESCRIPTION WHATSOEVER (COLLECTIVELY, "GUARANTEED OBLIGATIONS") WHICH MAY AT ANY TIME BE IMPOSED UPON, INCURRED BY OR AWARDED AGAINST LENDER AS A RESULT OF ANY OF THE FOLLOWING:**[169]

(a) **PROCEEDS PAID UNDER ANY INSURANCE POLICIES (OR PAID AS A RESULT OF ANY OTHER CLAIM OR CAUSE OF ACTION AGAINST ANY PERSON OR ENTITY) BY REASON OF DAMAGE, LOSS OR DESTRUCTION TO ALL OR ANY PORTION OF THE MORTGAGED PROPERTY, TO THE FULL EXTENT OF SUCH PROCEEDS NOT PREVIOUSLY DELIVERED TO LENDER, BUT WHICH, UNDER THE TERMS OF THE LOAN DOCUMENTS, SHOULD HAVE BEEN DELIVERED TO LENDER;**

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boy acts," for which the borrower remains personally liable to the lender for any loss, cost, damage or expense suffered by the lender as a result of such acts. *See* Annotated Promissory Note, Rider 5 (Optional Exculpation Provisions), for a more detailed explanation of these concepts as they relate to a borrower. Similarly, in these types of non-recourse loans, guarantors often have no liability for payment of the indebtedness, but rather are liable only for losses, costs, damages and expenses incurred by or imposed upon a lender as a result of such "bad boy acts" of the borrower, the guarantor (or another guarantor), or an affiliate or related party of the borrower or the guarantor. In this instance, the Guaranty essentially functions as an indemnity. Some lenders also include a provision (such as is found in the last paragraph of Section 2 of this Example 4) that make the guarantor directly and primarily liable for all indebtedness under the loan upon the occurrence of certain events. Finally, some lenders use a separate indemnity agreement pursuant to which borrower indemnifies the lender in relation to the "bad boy acts" and often require a third-party the guarantor to guarantee the borrower's obligations under the indemnity agreement.

[169] The items set forth in clauses (a) through (j) represent common "carve-outs" or exceptions in a non-recourse loan transaction. Typically, in a non-recourse loan, these same items are contained in each corresponding Guaranty as the Guaranteed Obligations of Guarantor. Accordingly, if in the course of pursuing the lender's remedies after the occurrence of a default, the lender correctly determines that one or more of these items has occurred, then the guarantor (similar to the borrower) is liable for each such item. These non-recourse carve-outs represent the lender's efforts to protect itself from, and encourage the borrower and the guarantor to prevent, the loss or erosion of value of the mortgaged property or the inappropriate diversion of related proceeds. Generally, these are acts or omissions that no prudent property owner would allow in the ordinary course of business.

(b) **PROCEEDS OR AWARDS RESULTING FROM THE CONDEMNATION OR OTHER TAKING IN LIEU OF CONDEMNATION OF ALL OR ANY PORTION OF THE MORTGAGED PROPERTY, OR ANY OF THEM, TO THE FULL EXTENT OF SUCH PROCEEDS OR AWARDS NOT PREVIOUSLY DELIVERED TO LENDER, BUT WHICH, UNDER THE TERMS OF THE LOAN DOCUMENTS, SHOULD HAVE BEEN DELIVERED TO LENDER;**

(c) **ALL TENANT SECURITY DEPOSITS OR OTHER REFUNDABLE DEPOSITS PAID TO OR HELD BY OR AN BEHALF OF BORROWER OR ANY OTHER PERSON OR ENTITY IN CONNECTION WITH LEASES OF ALL OR ANY PORTION OF THE MORTGAGED PROPERTY WHICH ARE NOT APPLIED IN ACCORDANCE WITH THE TERMS OF THE APPLICABLE LEASE OR OTHER AGREEMENT;**

(d) **RENT AND OTHER PAYMENTS RECEIVED FROM TENANTS UNDER LEASES OF ALL OR ANY PORTION OF THE MORTGAGED PROPERTY PAID MORE THAN ONE (1) MONTH IN ADVANCE;**

(e) **RENTS, ISSUES, PROFITS AND REVENUES OF ALL OR ANY PORTION OF THE MORTGAGED PROPERTY RECEIVED OR APPLICABLE TO A PERIOD AFTER ANY NOTICE OF DEFAULT FROM LENDER UNDER THE LOAN DOCUMENTS, IN THE EVENT OF ANY DEFAULT THEREUNDER, WHICH ARE NOT EITHER APPLIED TO THE ORDINARY AND NECESSARY EXPENSES OF OWNING AND OPERATING THE MORTGAGED PROPERTY OR PAID TO LENDER;**

(f) **DAMAGE OR WASTE TO THE MORTGAGED PROPERTY AS A RESULT OF THE INTENTIONAL MISCONDUCT OR GROSS NEGLIGENCE OF BORROWER OR ANY OF ITS PRINCIPALS, OFFICERS, MANAGERS, MEMBERS OR GENERAL PARTNERS, ANY GUARANTOR, ANY INDEMNITOR, OR ANY AGENT OR EMPLOYEE OF ANY SUCH PERSONS, OR ANY REMOVAL OF ALL OR ANY PORTION OF THE MORTGAGED PROPERTY IN VIOLATION OF THE TERMS OF THE LOAN DOCUMENTS, TO THE FULL EXTENT OF THE LOSSES OR DAMAGES INCURRED BY LENDER ON ACCOUNT OF SUCH DAMAGE OR REMOVAL;**

(g) **FAILURE BY BORROWER TO PAY ANY VALID TAXES, ASSESSMENTS, CLAIMS OF MECHANICS OR MATERIALMEN OR OTHER CLAIMS WHICH COULD CREATE LIENS ON ANY PORTION OF THE MORTGAGED PROPERTY WHICH WOULD BE SUPERIOR TO THE LIEN OR SECURITY INTEREST CREATED UNDER THE DEED OF TRUST OR THE OTHER LOAN DOCUMENTS, TO THE FULL EXTENT OF THE AMOUNT CLAIMED BY ANY SUCH LIEN CLAIMANT;**

(h) **ALL OBLIGATIONS AND INDEMNITIES OF BORROWER UNDER THE LOAN DOCUMENTS RELATING TO HAZARDOUS OR TOXIC**

SUBSTANCES OR COMPLIANCE WITH ENVIRONMENTAL LAWS AND REGULATIONS, TO THE FULL EXTENT OF ANY LOSSES OR DAMAGES (INCLUDING THOSE RESULTING FROM DIMINUTION IN VALUE OF ANY MORTGAGED PROPERTY) INCURRED BY LENDER AS A RESULT OF THE EXISTENCE OF SUCH HAZARDOUS OR TOXIC SUBSTANCES OR FAILURE TO COMPLY WITH ENVIRONMENTAL LAWS OR REGULATIONS;[170] [AND]

(i) **FRAUD OR MATERIAL MISREPRESENTATION BY BORROWER OR ANY OF ITS PRINCIPALS, OFFICERS, MANAGERS, MEMBERS OR GENERAL PARTNERS, ANY GUARANTOR, ANY INDEMNITOR OR ANY AGENT, EMPLOYEE OR OTHER PERSON AUTHORIZED OR APPARENTLY AUTHORIZED TO MAKE STATEMENTS OR REPRESENTATIONS ON BEHALF OF BORROWER, ANY PRINCIPAL, OFFICER, MANAGER, MEMBER OR GENERAL PARTNER OF BORROWER, OR ANY GUARANTOR OR ANY INDEMNITOR, TO THE FULL EXTENT OF**

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[170] Given the specifics of a transaction, Guarantor and Lender may view this particular item as providing insufficient specificity and may add to Section 1.1 of the Guaranty definitions for "hazardous or toxic substances" and "environmental laws or regulations," and accordingly may modify this provision to make reference to such defined terms instead of these general references to provide greater certainty. Such definitions could also be incorporated by reference to the Deed of Trust or one of the other Loan Documents. Typical definitions include: (A) "Environmental Law: Any federal, state, or local law, statute, ordinance, or regulation, whether now or hereafter in effect, pertaining to health, industrial hygiene, or the environmental conditions on, under, or about the Mortgaged Property, including without limitation, the following, as now or hereafter amended: Comprehensive Environmental Response, Compensation, and Liability Act of 1980 ("CERCLA"), 42 U.S.C. § 9601 *et seq*.; Resource, Conservation and Recovery Act ("RCRA"), 42 U.S.C. § 6901 *et seq*. as amended by the Superfund Amendments and Reauthorization Act of 1986 ("SARA"), Pub. L. 99-499, 100 Stat. 1613; the Toxic Substances Control Act, 15 U.S.C. § 2601 *et seq*.; Emergency Planning and Community Right to Know Act of 1986, 42 U.S.C. § 11001 *et seq*.; Clean Water Act ("CWA"), 33 U.S.C. § 1251 *et seq*.; Clean Air Act ("CAA"), 42 U.S.C. § 7401 *et seq*.; Federal Water Pollution Control Act ("FWPCA"), 33 U.S.C. § 1251 *et seq*.; and any corresponding state laws or ordinances including, but not limited to, the TEXAS WATER CODE ANN. ("TWC") § 26.001 *et seq*.; Texas Solid Waste Disposal Act, TEXAS HEALTH & SAFETY CODE ANN. ("THSC") § 361.001 *et seq*.; and the regulations, rules, guidelines, or standards promulgated pursuant to such laws, statutes and regulations, as such statutes, regulations, rules, guidelines, and standards are amended from time to time;" and (B) "Hazardous Substance: Any substance, product, waste, or other material which is or becomes listed, regulated, or addressed as being a toxic, hazardous, polluting, or similarly harmful substance under any Environmental Law, including without limitation: (i) any substance included within the definition of "hazardous waste" pursuant to Section 1004 of RCRA; (ii) any substance included within the definition of "hazardous substance" pursuant to Section 101 of CERCLA; (iii) any substance included within (a) the definition of "regulated substance" pursuant to Section 26.342(13) of TWC; or (b) the definition of "hazardous substance" pursuant to Section 361.003(11) of THSC; (iv) asbestos; (v) polychlorinated biphenyls; (vi) petroleum products; (vii) underground storage tanks, whether empty, filled or partially filled with any substance; (viii) any radioactive materials, urea formaldehyde foam insulation or radon; (ix) any substance included within the definition of "waste" pursuant to Section 30.003(b) of TWC or "pollutant" pursuant to Section 26.001(13) of TWC; and (x) any other chemical, material or substance, the exposure to which is prohibited, limited or regulated by any governmental authority on the basis that such chemical, material or substance is toxic, hazardous or harmful to human health or the environment."

ANY LOSSES, DAMAGES AND EXPENSES OF LENDER ON ACCOUNT THEREOF [.] [; AND][171]

(j) **FOR ANY AMOUNTS PAID UNDER LEASES CONTAINING EARLY LEASE TERMINATION OPTIONS OR OTHERWISE PAID BY ANY TENANT(S) IN CONSIDERATION OF AN EARLY TERMINATION OF ANY LEASE AND NOT DELIVERED TO LENDER TO BE HELD IN ACCORDANCE WITH THE DEED OF TRUST.[172]**

Notwithstanding anything to the contrary in this Guaranty or any of the other Loan Documents, Guarantor shall be directly and primarily liable, on a joint and several basis, for all indebtedness evidenced by the Note and for all obligations of Borrower under the Loan Documents (and such indebtedness and obligations shall be included within the term "<u>Guaranteed Obligations</u>" hereunder)[173] if (i) Borrower or any employee, agent or designee of Borrower should raise any defense, counterclaim or allegation in any foreclosure action by Lender relative to the Mortgaged Property or any part thereof in which Borrower or such representative does not prevail, (ii) [Borrower fails to maintain its status as a single purpose entity, as required by, and in accordance with the terms and provisions of, the Deed of Trust[174]]; (iii) Borrower fails to obtain Lender's prior written

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[171] *Blue Hills Office Park LLC v. JP Morgan*, 477 F. Supp. 2d 366 (D. Mass. 2007) (court held that the plain language of the guaranty controlled where evidence showed that borrower committed fraud when it failed to disclose a zoning settlement and was paid substantial funds that were required to be paid to the lender and the guaranty provided that in the event of fraud the guarantor was fully liable for the deficiency).

[172] This <u>clause (j)</u> is used only for retail or office properties.

[173] In addition to the standard "bad boy" acts enumerated in <u>clauses (a) through (j)</u> above, some lenders often provide that the loan becomes fully recourse against the borrower and the guarantor upon the occurrence of certain events that are either considered particularly egregious or within the borrower's or the guarantor's control, such as (i) a sale or subsequent encumbrance of the collateral in violation of the loan documents without the lender's prior written consent, (ii) a voluntary bankruptcy (*see* preceding annotation to this <u>Rider 1</u>, *supra*), (iii) any resistance to foreclosure or other enforcement proceedings, or (iv) any assertion of lender liability claims or other counterclaims in an enforcement proceeding. These provisions are commonly referred to as "springing recourse" clauses. This Guaranty also incorporates a provision that any limitation on Guarantor's liability is not intended to relieve or limit Guarantor's liability under a separate indemnity agreement or other document executed by Guarantor in connection with the Loan. In *111 Debt Acquisition LLC v. Six Ventures, Ltd. et al.*, the court upheld a springing recourse provision that imposed liability upon the borrower if "[h]older's rights of recourse to the property which is then subject to the mortgage are suspended, reduced or impaired by or as a result of any act, omission or misrepresentation of [borrower] or any other party now or hereafter liable for any part of the loan evidenced by this Note and accrued interest thereon, or by or as a result of any case, action, suit or proceeding to which [borrower] or any such other party voluntarily becomes a party..." No. C2-08-768, U.S. District Court, S.D.Ohio, Eastern Division, Opinion and Order dated February 18, 2009, and published at 2009 WL 414181.

[174] *LaSalle v. Mobile*, 367 F. Supp. 2d 1022 (E.D. La. 2004) (court found that the borrower, by changing its bylaws, violated its obligation to maintain its single purpose status, and therefore triggered the springing liability guaranty for the entire debt). Many life insurance companies and practically all "conduit" lenders securitizing loans in the capital markets require that the borrower be and remain a single-purpose, single-asset, bankruptcy-remote entity (commonly referred to as a "<u>SPE</u>") throughout the term of the loan. As the means of enforcing this requirement, these types of lenders make the failure to maintain the SPE a specific default under the loan

consent to any subordinate financing or other voluntary lien encumbering the Mortgaged Property;[175] (iv) Borrower fails to obtain Lender's prior written consent to any assignment, transfer, or conveyance of the Mortgaged Property or any interest therein as required by the Deed of Trust; or (v[176]) a receiver, liquidator or trustee of Borrower or of Guarantor or

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documents, and also require that the loan be fully recourse to a financially responsible party (*i.e.*, the guarantor) with respect to this requirement. The capital markets (specifically, the rating agencies) take this position as fundamental to the structuring of loans for deposit into a "pool" of similar loans and the subsequent issuance of certificates to purchasers of the securitization (also called commercial mortgage backed securities or "CMBS"). In a CMBS issuance, tranches or strips of the entire pool are rated and then sold. The purchasers (typically called "certificate holders") view these tranches as being similar to bonds. Consequently, the payment stream from the notes needs to be uninterrupted and lender remedies readily available. Since a bankruptcy typically effects the payment stream and the remedies available to the lender, the bankruptcy of the borrower (or the inclusion of the borrower in the bankruptcy of an Affiliate) needs to be mitigated against by structuring the loan in a manner such that the certificate holders will not bear this bankruptcy risk. The risk of default and of failure of collection must be minimized, and the SPE structure and the corresponding recourse against the guarantor is one of the means for doing so.

Essentially, a SPE is an entity whose purpose, power and authority are limited in that (i) it may only own and operate a single property, (ii) it may not engage in any other business unrelated to the mortgaged property and the financing thereof, and (iii) it may not have any assets or liabilities other than the mortgaged property and related equipment, the loan and normal trade account payables. Generally, a SPE is a corporation, limited partnership, limited liability company, or, in certain limited cases, a trust. Furthermore, a SPE must expressly be required to abide by specific "separateness" covenants, which typically are contained in the loan documents, the SPE's organization documents, or both. Additional features may be implemented to strengthen the SPE structure, such as limited purpose and separateness covenants in the organizational documents of the general partner or managing member of the SPE, a "non-consolidation" legal opinion, an "independent" director whose vote is required for a voluntary bankruptcy or reorganization, etc. Note, however, that coupling the SPE structure with full recourse against the guarantor will not completely eliminate an SPE's ability to seek bankruptcy protection (or prevent an SPE from being included in a related party's bankruptcy). It will merely mitigate against such possibility. In other words, the SPE structure attempts to make the borrower not "bankruptcy-proof" but merely "bankruptcy-remote." Not surprisingly, the respective rating agencies each have their own SPE requirements, which vary by property type, loan size (in relation to the CMBS pool) and the borrower.

Much has been written concerning SPEs in CMBS transactions. *See generally*, Kevin A. Sullivan, A Guide to Dealing With a Conduit Lender, 34th ANNUAL WILLIAM W. GIBSON, JR. MORTGAGE LENDING INSTITUTE (2000); William L. Meyers, The Use of Bankruptcy-Remote Entities in Real Property Securitizations and Structured Financings, California Real Property Journal, Vol. 15, No. 2; Joseph Forte, A Capital Markets Mortgage: A Ratable Model for Main Street and Wall Street, Real Property Probate and Trust Law Journal, Vol. 31, No. 3 (Fall 1996). In addition, the websites for the CMBS trade organization, Commercial Mortgage Securities Association (www.cmbs.org), and the rating agencies website are helpful resources in understanding the use of SPEs and CMBS loans (Fitch's is www.cmbs.org; www.fitchibca.com; Moody's is www.moodys.com; and Standard & Poors' is www.standardandpoors.com).

[175] *CSFB 2001-CP4 Princeton Park Corporate Center, LLC vs. SB Rental I, LLC, et al.*, No. L-7224-06, Superior Court of New Jersey, Law Division, Middlesex County, unpublished transcript of an oral opinion and order issued March 28, 2007 (the guaranties provided for springing liability if a subordinate mortgage was placed on the mortgaged property, which occurred and the court held the guarantors liable for the full amount of the debt); *Heller Financial v. Lee*, 2002 U.S. Dist. LEXIS 15183 (N.D. Ill. August 12, 2002) (the court found that the carve out provision in the note, that prohibited the filing of liens against the mortgaged property without the lender's consent, was violated and held the borrower liable for the entire amount of the deficiency).

[176] Guarantor is sometimes able to negotiate a "middle-ground" on this issue, limiting Guarantor's personal liability to any costs and losses incurred by Lender arising out of the actions described under items (i), (ii), (iii), (iv) and (v) rather than for the entire indebtedness.

any guarantor shall be appointed, or if Borrower or Guarantor or any guarantor shall be adjudicated a bankrupt or insolvent, or if any petition for bankruptcy, reorganization or arrangement pursuant to any Debtor Relief Law shall be filed, consented to, or acquiesced in, by Borrower or Guarantor or any guarantor, or if any action or proceeding for the dissolution or liquidation of Borrower or Guarantor or any guarantor shall be instituted or commenced by or against Borrower or Guarantor or any guarantor under any Debtor Relief Law[177]. Furthermore, all amounts for which Guarantor is fully and personally liable and subject to legal action hereunder shall include all liabilities, obligations, losses, damages, costs and expenses (including, without limitation, attorneys' fees), causes of

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[177] Many Texas practitioners, however, question the enforceability of a springing recourse provision (such as the example provision in this alternative paragraph of the Guaranty) in a bankruptcy context, and the authors are aware of no controlling Texas case ruling directly on this point. There are, however, several cases from other jurisdictions upholding a springing recourse clause for bankruptcy. *See* FDIC v. Prince George Corp., 58 F.3d 1041 (4th Cir., S.C., 1995); *see also* First Nationwide Bank v. Brookhaven Realty Association, 637 N.Y.S. 2d 418 (N.Y. App. 1996) (the loan provided for full recourse if the borrower filed for bankruptcy and such filing was not dismissed before the expiration of 90 days. The court stated: "As a bankruptcy default clause is enforceable under the laws of this State (see, W.F.M. Rest. v Austern, 35 N.Y.2d 610), the one at issue here should be enforced. The appellants are bound by the terms of the contract and enforcement of the bankruptcy default clause is neither inequitable, oppressive, or unconscionable").

Generally, clauses that provide for the automatic modification or termination of an executory contract or unexpired lease upon the insolvency or financial condition of a debtor, or upon the commencement of a bankruptcy case by a debtor, are invalid and unenforceable. *See* 11 U.S.C. § 365(e)(1) (2009). These clauses are commonly referred to as "*ipso facto*" clauses. A clause that creates a springing recourse liability might arguably qualify as an *ipso facto* clause. Careful analysis must be made regarding what document contains the potentially offending clause and the parties to that document. Generally, the provisions of the Bankruptcy Code that invalidate provisions that spring into effect upon insolvency or bankruptcy and modify a contract are designed only to protect a debtor. Also, these protections only relate to modifications contained in contracts with a debtor. If the springing recourse is activated by a clause in a guaranty between a lender and a non-debtor guarantor, then the springing recourse provision will not likely qualify as an *ipso facto* clause under the Bankruptcy Code. Likewise, if the document creates springing recourse liability for a non-debtor third party, the modification clause should not offend the provisions of the Bankruptcy Code prohibiting *ipso facto* clauses. Only clauses that modify the liability of a debtor and are contained in a document to which the debtor is a party should be invalidated by Section 365 of the Bankruptcy Code.

An important exception to this general rule occurs when this type of "*ipso facto*" clause appears in a contract to make a loan, extend financial accommodation or to provide debt financing. *See id.* § 365(e)(2) (2009). *Ipso facto* clauses in these types of agreements are specifically exempted from invalidation. *See id*. Obviously a promissory note between a borrower and a lender would qualify as a "loan." Therefore, a springing recourse clause that modifies the terms of a note would likely be exempt from invalidation under this exception. Also, a guaranty is considered as a "financial accommodation" under Section 365 of the Bankruptcy Code. *See* In re Sun Runner Marine, Inc., 945 F.2d 1089 (9th Cir. 1991). Thus, a similar provision in a guaranty should also be protected under this exemption.

Whether a clause providing for springing liability is enforceable within the context of section 365 of the Bankruptcy Code may be irrelevant, however, since the operation of such a clause may act as a preferential transfer under Section 547(b) of the Bankruptcy Code. A preferential transfer, to the extent that such transfer is not defensible under Section 547(c) of the Bankruptcy Code, could be avoided by a debtor or successor trustee. A preference would occur where the clause creating springing recourse liability transfers an interest of a debtor in property, and such transfer allows the creditor to receive more on account of an antecedent debt than it otherwise would have received without such transfer. *See* 11 U.S.C. §547(b) (2009).

action, suits, claims, demands and judgments of any nature or description whatsoever which may at any time be imposed upon, incurred by or awarded against Lender in connection with this Section 2.1. Nothing contained in this section shall (1) be deemed to be a release or impairment of the indebtedness evidenced by the Note or the obligations of Borrower under the Note or the other Loan Documents or the lien of the Loan Documents upon the Mortgaged Property, or (2) preclude Lender from foreclosing under the Loan Documents in case of any Default or from enforcing any of the other rights or remedies of Lender, or (3) release, limit or impair in any way whatsoever any other obligations of Guarantor under this Guaranty (except to the extent provided in this Section) or under any [Environmental Indemnity Agreement or] other Loan Document to which Guarantor is a party.]

Section 2.2, Guaranty of Performance. This Section should be deleted.[178]

Additional language regarding confirmation of limited liability (*include at the end of any of the foregoing options, as appropriate*):[179]

[Any reduction of Guarantor's liability under this Guaranty shall be effective only upon the execution and delivery by Lender of a written confirmation that the conditions or requirements necessary to allow such reduction have been satisfied and discharged in full to Lender's satisfaction and, in each instance, Lender shall have the right to condition delivery of such written confirmation upon its receipt and approval of such information and documentation (which may include, as applicable, an updated appraisal to be provided at Borrower's or Guarantor's expense) as Lender may require.]

[178] A guaranty covering only non-recourse carve-outs would require further revisions to this Guaranty beyond the scope of this presentation. The optional provisions in this Rider 1 regarding a guaranty of certain "bad boy" acts is primarily intended for the reader to understand the conceptual differences between a non-recourse guaranty and a more standard form of recourse guaranty.

[179] This additional language is intended to address the aforementioned concerns with respect to the methodology used to determine the satisfaction or lack of satisfaction of a "burn off" requirement. Under this provision, Guarantor is not released from liability until Lender has established the satisfaction of the condition or conditions in question and such determination has been confirmed in writing.

Rider 2

ADDITIONAL CONSTRUCTION LOAN PERFORMANCE OBLIGATIONS[180]

Example (*Additional Language for Guaranty of Real Estate Construction Loan*):[181]

Section 1.1 Definitions. The following definitions should be added or modified, as applicable:

> **[Aggregate Cost: All costs incident to the Loan, the acquisition of the Land, the construction of the Improvements on the Land, and if applicable, the leasing and operation of the Improvements, through the maturity date of the Loan.][182]**
>
> **[Borrower's Deposit: Any deposit by Borrower with Lender pursuant to the Loan Documents in an amount equal to (i) the actual unpaid Aggregate Cost**

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[180] We recommend that these provisions be incorporated into the Guaranty if the Loan is made for the purpose of funding the construction of Improvements.

[181] A "construction," "performance" or "completion" guaranty involves the timely lien-free completion of the improvements in a project that the borrower has agreed to construct pursuant to a construction loan agreement. The nature of a completion guaranty is such that, if challenged by a guarantor, the most effective remedy is a suit for specific performance. This remedy may be difficult for a court to fashion, however, as the remedy is equitable in nature and is available only if a court finds that the legal remedy of damages is not available. *See* McNutt v. Intratex Gas Co., 600 S.W.2d 947, 949 (Tex. Civ. App.—Waco 1980, writ ref'd n.r.e.). Most often lenders that experience a borrower's failure to complete a project choose not to enter the legal morass that awaits an adventure in the courts. Therefore, lenders generally do not avail themselves of the courts to enforce the completion provisions of a guaranty in a construction loan and there is an almost complete lack of legal precedent in relation to completion guaranties. *See* Kymson F. Des Jardins, Completion Guaranties: A Review of the Concept and the Execution, 23 REAL ESTATE LAW JOURNAL 141 (1994) (where the author states that, at that time, there were only two published decisions that discuss the measure of damages under a guaranty of completion: Glendale Fed. Sav. & Loan Assn. v. Marina View Heights Dev. Co., 135 Cal. Rptr. 802 (Cal. App 4th 1977) and 1633 Assocs. v. Uris Bldgs. Corp., 66 A.D. 2d 237, 414 N.Y.S.2d 125 (N.Y. App. 1979)). The Massachusetts Supreme Court has also dealt with the issue. *See* Norway Plains Sav. Bank v. Moore, 130 Mass. 129 (1883). For another view of completion guaranties and the lack of authority, *see* Patrica Frobes and Joseph L. Coleman, Drafting Completion Guaranties (with Form), THE PRACTICAL REAL ESTATE LAWYER (September 1995).

The construction of many projects is performed by contractors or major subcontractors that have furnished payment and performance bonds to the owner. Disputes relating to the failure to complete construction are often dealt with by the owner, the contractor and the bonding company. Experienced lenders will monitor such disputes while being careful not to jeopardize the owner's right to recovery from the bonding company. As a consequence of the difficulty of enforcing completion guaranties, and the fact that in many projects the contractor or contractors have furnished payment and performance bonds, most disputes between lenders and borrowers have been handled out of court.

See also annotations to Section 2.2 (Guaranty of Performance), *supra*.

[182] The scope of this definition is expansive in that, in addition to the typical construction and leasing costs, the costs of operations are also included. This concept may include amounts for which Guarantor did not contemplate guaranteeing payment. As a practical matter, it requires Guarantor to carefully review the loan budget and use of proceeds provisions of the Loan Documents.

<u>minus</u> (ii) (A) any unadvanced portion of the Loan to which Borrower is entitled under the Loan Documents and (B) the portions of the Aggregate Cost that are to be paid by Borrower from other funds that, to Lender's satisfaction, are available, set aside and committed to pay the actual unpaid Aggregate Cost.][183]

<u>Guaranteed Indebtedness</u>: Insert **["the making of required Borrower's Deposits and"]**[184] after the words "without limitation," and before the words "any indemnity obligations" in <u>clause (i)(a)</u> of such definition.

[<u>Guaranteed Obligations</u>: Collectively, the Guaranteed Indebtedness and all other obligations, duties and liabilities of Borrower under the Loan Documents. The Guaranteed Obligations shall include, by means of example only and without limiting the generality of the foregoing, (i) that the Improvements will be constructed and completed in accordance with the Loan Agreement[185] **and with the Plans and all applicable Laws, (ii) that the Improvements will be completed and ready for occupancy, including delivery of any certificates required by Law or the Loan Agreement, on or before the date required in the Loan Agreement, (iii) the timely payment of all taxes and assessments due and payable in connection with the Mortgaged Property, and (iv) the maintenance of all insurance (and the timely payment**

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[183] The "Borrower's Deposit" concept is a common construction lending requirement pursuant to which the lender can ensure that there are sufficient funds from which the borrower can complete the construction of the Improvements. The requirement for the borrower to deliver such funds to the lender typically arises in three (3) fact situations. First, the lender may require the borrower to deposit with the lender <u>all</u> of the borrower's equity contribution for the construction. This equity contribution is normally calculated as the difference between the total construction costs and the amount of the loan. The lender would disburse such equity proceeds prior to the advancement of any proceeds under the loan beyond those funds initially advanced at the closing of the loan. Second, if the borrower has agreed to a mezzanine financing transaction as an equity contribution, then the lender will require these proceeds to be similarly deposited with and disbursed by the lender. Finally, if during the course of construction, the lender determines that the construction costs of the project exceed or will exceed the original construction budget, the lender will then immediately require the borrower to deposit the amount of the overage with the lender as assurance that adequate funds have been set aside to complete construction. The lender then will disburse to the borrower the funds constituting the Borrower's Deposit towards construction costs before advancing any additional loan proceeds. The borrower often will resist the deposit of any of these funds and may propose that the lender merely not commence funding, or cease funding, the loan until the borrower has paid the amounts in question during the normal construction process. The borrower also may request that the lender and the borrower fund prorata portions to each construction draw request until the conditions otherwise requiring a Borrower's Deposit no longer exist. Clearly, all parties to a loan transaction will need to monitor the source and use of funds throughout the course of construction for this provision to appropriately address the desired goal of having sufficient funds <u>timely</u> available to satisfy the Aggregate Cost of the project.

[184] If the lender requires a guarantee of completion of the Improvements, this obligation could explicitly require the guarantor to fund an amount that the borrower is required to fund as a part of the Borrower's Deposit.

[185] *See* annotation to definition of "Loan Agreement" in <u>Section 1.1</u> (Definitions), *supra*.

of all premiums thereon), all in strict accordance with the terms of the Loan Agreement, the Deed of Trust and the other Loan Documents.][186]

[Improvements: All buildings, structures and other improvements to be constructed on the Land in accordance with the Loan Agreement.]

[Loan: The loan for the acquisition of the Land and the construction of the Improvements thereon from Lender to Borrower in the stated principal amount of ________________ and No/100 Dollars ($_______________) evidenced by the Note and governed and secured by the Loan Agreement, the Deed of Trust and the other Loan Documents.][187]

[Plans: The plans and specifications and all modifications thereof and additions thereto, as more particularly described in the Loan Agreement.]

Section 2.2, Guaranty of Performance. Replace the provisions of this Section with the following:

[2.2 **Guaranty of Performance.**[188] **Guarantor hereby unconditionally and irrevocably guarantees to Lender the full, complete and timely performance of all of the Guaranteed Obligations, including, without limitation, that Borrower will duly and punctually perform, observe and comply with all of the terms, covenants and conditions of the Note, the Loan Agreement, the Deed of Trust and the other Loan Documents, whether according to the present terms thereof, at any earlier or accelerated date or dates as provided therein, or pursuant to any extension of time or to any change or changes in the terms, covenants or conditions thereof now or hereafter made or granted. If any of the Guaranteed Obligations are not complied with or performed in any respect whatsoever, [and without the necessity of any notice from Lender to Guarantor,] Guarantor agrees to (i) assume all responsibility for the full, complete and timely performance of the Guaranteed Obligations and, at Guarantor's own cost and expense, to perform and cause performance of all the Guaranteed Obligations in strict accordance with the terms of the**

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[186] Although a guaranty of the borrower's obligations under a construction loan agreement necessarily includes the borrower's obligation to complete construction of the Improvements, the lender may, with this type of provision, specifically describe those non-monetary construction obligations. The purpose of including these specific obligations is to clearly articulate to Guarantor what performance obligations are included. Care must be taken to ensure that the "articulation" does not inadvertently limit the performance obligations. The provisions are intended to clearly establish the performance and construction obligations being guaranteed, and to prevent Guarantor from later asserting that the Guaranty is only a payment guaranty, rather than a payment *and performance* guaranty. It remains unclear under Texas law, however, whether a lender may compel a guarantor to perform a borrower's non-monetary performance obligations. Presumably, a lender, pursuant to general contract law, should be entitled to enforce guaranteed performance obligations through an action for specific performance on a guaranty. However, the authors are not aware of any Texas case involving an action for specific performance on a guaranty in a loan context. *See* second annotation to this Rider 2 (Additional Construction Loan Performance Obligations), *supra*; *See also* first annotation to Section 2.2 (Guaranty of Performance), *supra*.

[187] *See* annotation to definition of "Loan" in Section 1.1 (Definitions), *supra*.

[188] Graber, Ned W. *The Completion Guaranty*, October 2007.

Loan Documents, including, without limitation, (A) to assume all responsibility for the completion of the Improvements and, at Guarantor's own cost and expense, to cause the Improvements to be fully completed in accordance with the Plans and the Loan Documents, and (B) to pay all bills in connection with the construction of the Improvements; and (ii) *INDEMNIFY, DEFEND AND HOLD LENDER HARMLESS FROM AND AGAINST ANY AND ALL LOSS, COST, LIABILITY OR EXPENSE THAT LENDER MAY SUFFER BY ANY REASON OF ANY SUCH NONCOMPLIANCE OR NONPERFORMANCE*. So long as all of such obligations are being performed by Borrower or Guarantor and no Default exists, Lender will make the Loan proceeds available under and subject to the terms of the Loan Agreement.[189] If after the occurrence of a Default, and without limiting Lender's rights and remedies, Lender, in its [sole and absolute] [reasonable] discretion, is dissatisfied with the progress of construction by Borrower or Guarantor, Lender may, at its option, [without notice to Guarantor or anyone else] [after first having given notice to Guarantor at the address set forth below in the manner prescribed herein for giving notice], cause completion of the Improvements either before or after commencement of foreclosure proceedings or before or after exercise of any other right or remedy of Lender against Borrower or Guarantor, with such changes or modifications in the Plans as Lender deems necessary and expend such sums as Lender, in its [sole and absolute] [reasonable] discretion, deems necessary or advisable to complete the Improvements. Guarantor hereby waives any right to contest any such expenditures by Lender. The amount of any and all expenditures made by Lender for the foregoing purposes or resulting or arising from Guarantor's failure to perform the Guaranteed Obligations pursuant to the terms hereof shall be immediately due and payable by Guarantor to Lender [upon demand] [(provided, however, that the failure of Lender to make such demand shall neither relieve nor discharge Guarantor in any respect of its obligations under this Guaranty, any condition or requirement of such demand to Guarantor's liability under this Guaranty being hereby waived by Guarantor)] together with interest at the Default Interest Rate. Lender does not have and shall never have any obligation to complete the Improvements or to take any action to cause such completion.[190]

[189] This clause is usually not included in a guaranty. Guarantors, however, often comment that it is not equitable for the lender to require the guarantor to complete construction while at the same time refusing to advance loan proceeds directly to the guarantor for such purposes. Otherwise, the guarantor would be required to fund further construction with the guarantor's own, separate funds. Obviously, if the guarantor is an affiliate or principal of the borrower, this scenario is a product of the borrower's failures. In the event the lender consents to funding loan proceeds directly to the guarantor for the completion of the improvements, the lender should condition these disbursements. Standard conditions include no bankruptcy or similar action, the cure of all defaults under the loan documents, and an indemnity in favor of the lender related to the guarantor's construction. The guarantor's right to complete construction may be further conditioned on the forming of a single purpose entity, the guarantor's succession to all of the borrower's rights under all of the construction and leasing documents, and the guarantor's legal right to enter and not trespass onto the mortgaged property.

[190] These clauses allow Lender to enter onto the Mortgaged Property before or after any foreclosure proceeding, complete construction and subsequently demand that Guarantor pay to Lender the amount of all related costs. Guarantor may resist this language because it allows the lender to seek reimbursement from Guarantor for costs of which Guarantor has no direct control. This issue also often arises between the lender and Borrower under the terms of the Loan Agreement. Despite the contractual right, the lender should carefully weigh the right to enter upon the mortgaged property prior to foreclosure due to issues of being deemed a "mortgagee-in-possession."

Guarantor further acknowledges and agrees that Guarantor may be required to perform the Guaranteed Obligations in full without assistance or support from Borrower or any other Person. Guarantor agrees that if all or any part of the Guaranteed Obligations shall not be punctually performed when and as stated in the Loan Documents, Guarantor shall, immediately [upon demand by Lender] [(provided, however, that the failure of Lender to make such demand shall neither relieve nor discharge Guarantor in any respect of its obligations under this Guaranty, any condition or requirement of such demand to Guarantor's liability under this Guaranty being hereby waived by Guarantor)], perform the Guaranteed Obligations. Lender may, but shall have no obligation to, make demand(s) at any time coincident with or after the time for performance of all or part of the Guaranteed Obligations, and demand(s) may be made from time to time with respect to the same or different items of the Guaranteed Obligations. [Such demand shall be made, given and received in accordance with the notice provisions hereof.] [; provided, however, that the failure to make, give or receive demand in accordance with the notice provisions hereof shall neither relieve nor discharge Guarantor in any respect of its obligations under this Guaranty, any condition or requirement of such demand to Guarantor's liability under this Guaranty being hereby waived by Guarantor.] The obligations and liability of Guarantor under this Section 2.2 shall not be limited or restricted in any way by the existence of, or by any terms of, the guaranty of payment under Section 2.1 of this Guaranty.]

Section 3.1, Certain Agreements and Waivers by Guarantor. Add the parenthetical phrase **["(including changes in the Plans or other terms or aspects of construction of the Improvements)"]** to clause (a)(viii)(A) after the words "or performance" and before the words "or any other terms thereof".[191]

Example of additional language for limiting Guarantor's liability to completion of Shell Improvements :[192]

[191] If the guarantor does not waive its right to object to any changes in the Plans or aspects of the construction of the Improvements, then any changes during construction, but before default, may allow the guarantor to claim that its obligations are limited to the original plans or possibly that the guarantor's obligations have been released. *McKnight v. Virginia Mirror Co.*, 463 S.W.2d 428 (Tex. 1971).

[192] As is always the case in drafting provisions which are intended to limit a guarantor's liability, the specific language employed is often the result of substantial negotiation between the parties, taking into account the particular facts surrounding the transaction. The limitation of liability language set forth in this example is typical of a situation in which there is a credit-enhancement guarantor as well as a negotiated "take out" purchaser of the project. In this situation, the lender has required as part of its loan approval that a financially viable third party both (i) ultimately guarantee the completion of the project and, more importantly, (ii) "take out" the construction loan prior to the obligation to fund monies beyond the completion of the "shell improvements." By way of example, this provision would require further modification if the "take out" was not tied to the "shell" completion. Rather than focusing on the particular facts of the example, the instructive "value" is in demonstrating the care which must be taken by a lender that elects to limit a guarantor's liability to (i) specifically describe as objectively as possible the standards which must be met for the limitation to become effective, and (ii) equally as important, require that no condition is deemed satisfied unless there is a written confirmation of that satisfaction from the lender to the guarantor. The last paragraph in proposed Section 2.2 is critical given the fact-intensive nature of the satisfaction of the condition, completion of the "shell improvements." In a construction project, this condition may not be satisfied for 14 to 16 months (or longer) and, during that rather lengthy period of time, under these provisions the guarantor

Section 2.2, Guaranty of Performance. Add the following at the beginning of the first sentence to Section 2.2 above in this Rider 2: **["Subject to the limitations set forth below in this Section 2.2,"]**.

Section 2.2, Guaranty of Performance. Add the following provisions at the end of Section 2.2 above in this Rider 2:

[Notwithstanding the foregoing, however, upon (i) completion of the "shell" portions of the buildings and other Improvements, excluding only tenant improvements to be made by Borrower or any tenant to space within the Improvements leased by a tenant pursuant to a written lease agreement, for the use and benefit of such tenant, (the "Shell Improvements") in accordance with the Loan Agreement, the Plans and all Laws, which completion must be certified to Lender by the construction consultant engaged by Lender with respect to construction of the Improvements, (ii) issuance to Borrower of a final certificate of occupancy for the Shell Improvements from the appropriate governmental authorities, and (iii) there being no continuing Default under any of the Loan Documents at the time of satisfaction of parts (i) and (ii) above in this paragraph, then Guarantor shall have no further liability or obligations under subparts (i) (A) and (B) above in the immediately preceding paragraph of this Section 2.2 with respect to the completion of the Improvements; provided, however, that Guarantor shall remain fully liable for all other Guaranteed Obligations in accordance with the terms of this Guaranty.

Satisfaction of the foregoing conditions necessary to allow a reduction of Guarantor's obligations or liability hereunder with respect to the Guaranteed Obligations as specifically provided above shall be determined by Lender in its [sole and absolute] [reasonable] discretion, and shall be effective only upon written confirmation from Lender to Guarantor that all of the conditions necessary to allow such reduction have been satisfied.][193]

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would be fully liable for all payment and performance obligations of the borrower until such condition is satisfied. Therefore, before any limitation becomes effective or a "release" of any obligation is given, the lender must have the opportunity for a "look back" as to the satisfaction by the borrower and the guarantor of, in this instance, the completion of the "shell improvements," and a determination that all of the payment and performance obligations which were required to have been performed to reach that objective were, in fact, satisfied in accordance with the loan documents.

[193] *See* last annotation to Rider 1 (Limitations of Guaranteed Indebtedness), *supra*.

Rider 3

SPECIFIC FINANCIAL COVENANTS

Add as Section 4.3 in the Guaranty:

Example 1: Liquidity Maintenance Covenant.[194]

[Guarantor covenants and agrees with Lender that Guarantor shall at all times throughout the term of the Loan maintain a minimum Liquidity of at least $_____________. [The failure of Guarantor to maintain such minimum Liquidity shall constitute a Default hereunder and under the other Loan Documents.] For purposes of this Section, "Liquidity" shall mean the sum of Guarantor's total assets that are cash, cash equivalents, certificates of deposit, accounts and other highly liquid investments (including marketable securities traded on a nationally-recognized public exchange) that are not pledged, hypothecated, subject to rights of offset or otherwise restricted, as determined by Lender [add other definition as the particular Lender requires].]

Example 2: Net Worth Maintenance Covenant.[195]

[Guarantor covenants and agrees with Lender that Guarantor shall at all times throughout the term of the Loan maintain a minimum Net Worth of at least $_____________. [The

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[194] This covenant is often used in instances where the lender is concerned that the borrower may need additional funds or support, or that the Guaranty is one of the primary sources of ready repayment. This covenant ensures that the guarantor is able to readily satisfy the Guaranteed Obligations (as opposed to liquidating assets, such as real estate or other non-liquid assets). This ratio is sometimes called a "quick asset ratio" or an "acid test." This type of ratio is much more stringent than other ratios because it only looks to those current assets that are most liquid in order to measure the guarantor's ability to pay obligations immediately. For a borrower, this provision would be expanded to include many ordinary trade receivables, which can also be quickly turned to cash. There is no uniform definition of liquid assets and the assets should be defined as specifically as possible in the particular covenant.

[195] This covenant is a net worth covenant and does not exclude assets that have no, or little, liquidation value and for which the method of evaluation varies greatly. Such assets include patents, trademarks, franchise, goodwill and the like which are normally excluded because they cannot be used to pay liabilities (this traditional view is somewhat moderated by the current explosion of intellectual property values). In order to change this provision to a tangible net worth covenant, an exclusion at the end of the existing definition would normally be added. A sample exclusion would read, "excluding, however, from the determination of total assets all assets that would be classified as intangible assets under generally accepted accounting principles, including, without limitation, goodwill, patents, licenses, trademarks, tradenames, copyrights and franchises."

Some lenders also exclude subordinated indebtedness (at least that which is subordinated specifically to the Guaranteed Obligations) from liabilities in calculating net worth, but this can have unintended consequences since the subordinated indebtedness is never true equity and under most circumstances will be counted as debt in determining solvency and for other similar purposes, unless deeply subordinated to all liabilities, which is normally not the case.

failure of Guarantor to maintain such minimum Net Worth shall constitute a Default hereunder and under the other Loan Documents.] For purposes of this Section, "Net Worth" shall mean (i) the sum of the aggregate total assets of Guarantor (based on fair market value less normal depreciation), less (ii) all liabilities of Guarantor (including liabilities for taxes and other contingent and indirect liabilities), all calculated in accordance with [GAAP] [the same accounting principles and practices used in preparing the financial statements furnished and to be furnished by Guarantor to Lender as provided in this Guaranty and the other Loan Documents], as determined by Lender [add other definition as the particular Lender requires].]

Example 3: Prohibition on Guaranteed Debt.[196]

[Guarantor shall not, without the prior written consent of Lender, guarantee the repayment or satisfaction of any indebtedness, obligations or liability of Borrower or any other Person whatsoever other than (i) the Guaranteed Indebtedness and Guaranteed Obligations pursuant to the terms of this Guaranty, and (ii) such currently existing indebtedness, obligations and liability for which Guarantor is already liable as a guarantor, as shown on the financial statements and other information delivered to and approved by Lender prior to the date of this Guaranty. Guarantor's failure to comply with the foregoing shall constitute a Default hereunder and under the other Loan Documents.]

[196] This restriction is designed to ensure that Guarantor has financial resources available to honor the Guaranty and does not accrue a significant amount of contingent liabilities that could adversely affect Guarantor's ability to pay and perform under the Guaranty.

Rider 4

FOREIGN GUARANTOR PROVISIONS

1. Add the following at the end of the third sentence in Section 6.4:

[Guarantor further agrees that service of process may be made upon Guarantor in care of the Borrower by certified or registered mail, return receipt requested, at the address specified in Section __ above.]

OR

Add the following at the end of Section 6.4:

[GUARANTOR FURTHER CONSENTS AND AGREES TO SERVICE OF ANY SUMMONS, CITATION, COMPLAINT OR OTHER LEGAL PROCESS IN ANY SUCH SUIT, ACTION OR PROCEEDING BY REGISTERED OR CERTIFIED U.S. MAIL, RETURN RECEIPT REQUESTED, POSTAGE PREPAID, TO THE GUARANTOR AT THE ADDRESS FOR NOTICES DESCRIBED HEREIN OR TO ______________________________ _______________________ (ATTENTION: _________________________________ _____________), WITH AN OFFICE AT __________________________ ___________________, U.S.A. (THE "PROCESS AGENT"). GUARANTOR HEREBY IRREVOCABLY APPOINTS THE PROCESS AGENT AS ITS TRUE AND LAWFUL AGENT AND ATTORNEY-IN-FACT IN ITS NAME, PLACE AND STEAD TO ACCEPT SUCH SERVICE OF ANY AND ALL WRITS, PROCESSES AND SUMMONSES. GUARANTOR AGREES TO MAINTAIN AT ALL TIMES AN AGENT IN ________ COUNTY, TEXAS, FOR THE PURPOSE OF ACTING AS SUCH AN AGENT AND ATTORNEY-IN-FACT. GUARANTOR FURTHER AGREES THAT THE FAILURE OF THE PROCESS AGENT TO GIVE ANY NOTICE OF ANY SUCH SERVICE OF PROCESS TO GUARANTOR SHALL NOT IMPAIR OR AFFECT THE VALIDITY OF SUCH SERVICE OR OF ANY JUDGMENT BASED THEREON. GUARANTOR CONSENTS AND AGREES THAT SUCH SERVICE SHALL CONSTITUTE IN EVERY RESPECT VALID AND EFFECTIVE SERVICE (BUT NOTHING HEREIN SHALL AFFECT THE VALIDITY OR EFFECTIVENESS OF PROCESS SERVED IN ANY OTHER MANNER PERMITTED BY LAW).][197]

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[197] This provision is necessary to avoid the time consuming and expensive procedures required for serving a guarantor in another country. Parties to a contract, including foreign guarantors, may designate an agent to receive service of process. *See* Nat'l Equip. Rental, Ltd. v. Szukhent, 375 U.S. 311 (1964); Pittsburgh Nat'l Bank v. Kassir, 153 F.R.D. 580, 583 (W.D. Pa. 1994). If the parties do not designate a domestic representative to receive service of process, service of process is governed almost exclusively by the Hague Convention On The Service Abroad of Judicial And Extrajudicial Documents In Civil Or Commercial Matters ("Hague Convention"). *See* HAGUE CONVENTION, 20 U.S.T. 361, T.I.A.S. No. 6638 (Nov. 15, 1965). Under the Hague Convention, each signatory country must designate a "Central Authority" to accept and serve judicial and extrajudicial documents. See *id*. at Art. 2. Certain signatory countries require documents to be translated into one of the official languages of the country and prohibit documents from being served by mail. *See id.* at Arts. 5 & 10. After the Central Authority serves notice of the lawsuit on the defendant, the Central Authority sends the plaintiff a certificate, identifying the

2. Add the following at the end of Payments Section 6.16:

[All references in this Guaranty to sums denominated in dollars or with the symbol "$" refer to the lawful currency of the United States of America, unless such reference specifically identifies another currency. If, for the purposes of obtaining or enforcing judgment against Guarantor in any court in any jurisdiction in connection with this Guaranty or any other document delivered in connection therewith, it becomes necessary to convert into any other currency (such other currency being referred to as the "Judgment Currency") an amount due in any currency (the "Obligation Currency") other than the Judgment Currency under this Guaranty or any other Loan Document to which Guarantor is a party, the conversion shall be made at the rate of exchange prevailing on the Business Day [*drafter will need to add a definition for Business Day*] immediately preceding the date of actual payment of the amount due, in the case of any proceeding in the courts of the State of Texas or in the courts of any other jurisdiction that would give effect to such conversion being made on such date, or, the date on which the judgment is given, in the case of any proceeding in the courts of any other jurisdiction (the applicable date as of which such conversion is made pursuant to this paragraph being hereinafter referred to as the "Judgment Conversion Date"). If, in the case of any proceeding in the court of any jurisdiction referred to in the preceding sentence, there is a change in the rate of exchange prevailing between the Judgment Conversion Date and the date of actual receipt for value of the amount due, Guarantor shall pay such additional amount (if any and in any event not a lesser amount) as may be necessary to ensure that the amount actually received in the Judgment Currency, when converted at the rate of exchange prevailing on the date of payment, will produce the amount of the Obligation Currency which could have been purchased with the amount of the Judgment Currency stipulated in the judgment or judicial order at the rate of exchange prevailing on the Judgment Conversion Date. The term "rate of exchange" in this paragraph means the spot rate of exchange at which Lender would, on the relevant date at or about 12:00 noon, be prepared to sell the Obligation Currency against the Judgment Currency. Any amount due from Guarantor under this paragraph shall be due as a separate debt and shall not be affected by judgment being obtained for any other amounts due under or in respect of any of the Loan Documents.][198]

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person who was served, and the method, date and place of service. However, the Hague Convention does not apply when process is served in the United States in accordance with applicable state or federal law. *See* Volkswagenwerk Aktiengesellschaft v. Schlunk, 486 U.S. 694, 700 (1988). According to the United States Supreme Court's interpretation of the Hague Convention, the requirements of the Hague Convention are triggered only when a party attempts to service judicial or extrajudicial documents in a foreign country. *See id.* Because all countries may not accept the United States' interpretation of the Hague Convention, it may be prudent to follow the Hague Convention procedures before taking a default judgment against a foreign guarantor. *See id.* at 706.

[198] This provision is added to transactions with foreign guarantors because of the possibility that a judgment may need to be enforced in a foreign country and the judgment amount could be adversely affected by fluctuations in the exchange rates within short periods of time. Whether a result of market forces or government intervention, the value in United States currency of a judgment rendered against the guarantor may change dramatically from the date such judgment is rendered and actual collection of the judgment. This provision is designed to have the guarantor compensate Lender for any potential loss caused by an exchange rate fluctuation

between the time of obtaining the judgment and the time of receipt of the funds pursuant to said judgment. If it is anticipated that the lender will need to resort to enforcement actions in a foreign jurisdiction or before a foreign court, prudent practice would be to consult foreign counsel about the effectiveness of this provision in such foreign jurisdiction and any requirements of local law or practice.

Rider 5

ARBITRATION OPTION

Section 1.1, Definitions. The following definition should be added:

> **[Dispute: Any action, dispute, claim or controversy of any kind or character whatsoever, whether in contract or tort, legal or equitable, or pursuant to statutory or common law.]**

Add the following as a new Section in Article VI of the Guaranty:

[6.___ Requirement of Arbitration.[199] Upon written notice from either Guarantor or Lender (whether delivered before or after the institution of any legal proceeding), any Dispute arising out of, pertaining to or in connection with this Guaranty or the Loan Documents, shall be determined by arbitration ("Arbitration") in accordance with the provisions of this Section 6.___.

(a) Governing Rules.[200] The Arbitration shall be conducted in ___________, Texas, and shall be administered by the American Arbitration

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[199] As a general rule, a guaranty does not typically contain an arbitration clause, as established jurisprudence and summary procedures allow the judicial system to be a comparatively reliable and predictable forum for enforcing a guarantor's obligations under a guaranty. Historically, doubts as to the objectivity of arbitration left many lenders feeling relatively comfortable with the judicial process. The era of lender liability in the 1980's and early 1990's, however, caused many lenders to seek alternative methods to limit exposure to class actions, punitive damages and "runaway" juries. Therefore, many lenders often now require that mandatory arbitration clauses be included in a guaranty. This form of arbitration clause addresses the primary issues that should be covered by an arbitration agreement to be used in connection with a guaranty: enforceability of the clause, applicable procedure, and preservation of the lender's remedies to pursue collateral and other ancillary rights.

[200] Historically, arbitration agreements were not favored at common law and, therefore, external authority was necessary to facilitate the enforcement of arbitration agreements. The Federal Arbitration Act (9 U.S.C. § 1 et seq.) (the "FAA"), for example, applies to a "contract evidencing a transaction involving commerce," a scope broad enough to cover most commercial transactions. Texas courts have recognized and enforced an agreement to arbitrate. *See, e.g.*, L.H. Lacy Co. v. City of Lubbock, 559 S.W.2d 348 (Tex. 1977). *See also* annotation to Section 6.18 (Waiver of Right to Jury Trial), *supra*. To be enforceable at common law, the arbitration clause must be sufficiently specific and comprehensive in its terms so as to provide for a complete procedure (*e.g.*, selection of arbitrators, selection of forum, identification of the applicable rules, etc.), the most common means of which is to incorporate by reference the rules of the AAA or some other nationally or regionally recognized organization supplying the necessary procedures. *See* L.H. Lacy Co., 559 S.W.2d at 351.

Since L.H. Lacy Co., Texas has adopted the Texas Arbitration Act (TEX. CIV. PRAC. & REM. CODE ANN. § 171.001 et seq. (West 2010)) (the "TAA"), which is based on the Uniform Arbitration Act. If an arbitration agreement is subject to both state and federal law and a conflict arises between the provisions of TAA and the FAA, the terms of the FAA will prevail. Generally, both the TAA and the FAA severely limit the situations in which an arbitration award can be vacated, modified or corrected TEX. CIV. PRAC. & REM. CODE ANN. § 171.088(a) (West 2010), (9 U.S.C. § 10(a)). Recently, however, the Texas Supreme Court has held that parties to an arbitration agreement can contractually agree that an arbitration award can be subject to judicial review for reversible error, and that the spirit of Texas law, which "recognizes and protects a broad freedom of contract" is not pre-empted by the FAA on this point. *See* NAFTA Traders, Inc. v. Quinn, 339 S.W.3d 84 (Tex. 2011) (holding that an arbitration

Association (the "AAA") in accordance with the terms of this Section 6.___, the Commercial Arbitration Rules of the AAA, and, to the maximum extent applicable, the Texas General Arbitration Act (Chapter 171 of the Texas Civil Practice and Remedies Code). In the event of any inconsistency between this Section and such rules and statutes, this Section shall govern and control. The Arbitration shall utilize only one arbitrator (the "Arbitrator") who shall be a practicing attorney licensed to practice law in the State of Texas and shall be knowledgeable in the subject matter of the Dispute. The Arbitrator shall be empowered to impose sanctions and to take such other actions as the Arbitrator deems necessary to the same extent to which a judge presiding over a court of competent jurisdiction would be empowered pursuant to the Federal Rules of Civil Procedure, the Texas Rules of Civil Procedure, and all other applicable Laws. Judgment upon any award rendered in the Arbitration may be entered in any court having jurisdiction over such subject matter. All statutes of limitations that would otherwise be applicable shall also apply to any Arbitration proceeding.

(b) No Waiver; Provisional Remedies, Self-Help and Foreclosure.[201] No provision of, nor the exercise of any rights under, this Section shall limit, diminish or restrict in any manner whatsoever the right of Lender during any Dispute to seek, utilize and employ any ancillary remedies, judicial or otherwise, for the purposes of realizing upon, preserving, protecting or foreclosing upon any property or collateral (including, without limitation, the Mortgaged Property), or any lien or security interest securing repayment of the Loan and the other obligations of Borrower or Guarantor under the Loan Documents. The institution and maintenance of such an action for judicial relief or pursuit of provisional or ancillary remedies shall not constitute a waiver of the right of Lender or Guarantor to submit the Dispute to Arbitration nor render inapplicable the compulsory nature of this Section 6.___.

(c) Miscellaneous. If enforcement of this Section 6.__ is not permitted under Section 171.002(b) of the Texas Civil Practice and Remedies Code, but same is permitted under the Federal Arbitration Act or applicable common law, all provisions of Chapter 171 of the Texas Civil Practice and Remedies Code shall

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agreement providing that an arbitrator does not have the authority to "render a decision which contains a reversible error of state or federal law . . . ", is in effect, an agreement for expanding judicial review of the arbitration award). Parties negotiating the terms of an arbitration provision in a guaranty or other loan document should give careful consideration from a strategic standpoint whether they would benefit more from arbitration proceedings that cannot be appealed (except for the limited circumstances permitted under the TAA or FAA) or whether a party can appeal the decision of an arbitrator.

[201] This arbitration clause provides, among other things, that injunctive relief to preserve the status quo of the mortgaged property (whether judicial or otherwise) is available to the lender during the pendency of any arbitration proceeding. *See* Ortho Pharm. Corp. v. Amgen, Inc., 882 F.2d 806 (3d Cir. 1989). Further, arbitrators can often grant injunctive relief as well. *See* Pacific Reinsurance Mgmt. Corp. v. Ohio Reinsurance Corp., 935 F.2d 1019 (9th Cir. 1991). It is often of critical importance to the lender that the lender's remedies to pursue collateral and right to use of the courts for ancillary matters be preserved and not relinquished in any manner.

apply, save and except for such Section 171.002(b). Lender and Guarantor hereby agree to keep all Disputes and Arbitration proceedings strictly confidential; provided, however, that Lender and Guarantor may disclose such confidential information as is necessary in any litigation between Lender and Guarantor or as required by applicable law and, on a confidential basis, to accountants, attorneys and other consultants in the ordinary course of business. The provisions of this Section 6.__ shall survive any termination, amendment, release or expiration of the Loan Documents, unless Lender and Guarantor expressly agree otherwise in writing.]

Rider 6

FORM OF GUARANTOR CONSENT

[*Attach the following consent to the applicable loan modification agreement*]

CONSENT OF GUARANTOR[202]

Each of the undersigned, as a guarantor ("Guarantor," whether one or more) of the loan (the "Loan") made by ________________, a _______________ ("Lender") to ________________, a ______________ ("Borrower") evidenced by the Note and secured by the Deed of Trust described in the foregoing Loan Modification Agreement (the "Modification Agreement") to which this Consent of Guarantor (this "Consent") is attached, hereby: (i) acknowledges and consents (jointly and severally) to each of the terms and provisions of the Modification Agreement; (ii) agrees (jointly and severally) that the execution and delivery of the Modification Agreement will in no way limit, diminish, preclude or reduce such Guarantor's obligations under its Guaranty (as each such Guaranty is described in the Modification Agreement); (iii) ratifies and confirms its Guaranty, including, without limitation, all interest and costs of collection, to and for the benefit of Lender; (iv) agrees (jointly and severally) that any and all indebtedness, obligations, duties and liabilities of Borrower created, imposed, modified, amended or increased by the terms of the Modification Agreement are hereby expressly included as part of the Guaranteed Obligations (as such term is defined in its Guaranty), including, without limitation, any increase in the amount of the Loan or of the indebtedness of Borrower to Lender (which increased amount, if any, is hereby expressly included as part of the Guaranteed Indebtedness [as such term is defined in its Guaranty]); (v) acknowledges and agrees (jointly and severally) that the Guaranteed Indebtedness includes the Loan, together with any and all other indebtedness now or at any time hereafter owing by Borrower to Lender, and each Guarantor (jointly and severally) hereby unconditionally and absolutely guarantees to Lender the payment when due of all such Guaranteed Indebtedness and increases thereof; (vi) acknowledges and agrees that its Guaranty is in full force and effect, and that the terms and provisions of its Guaranty cover and pertain to the Loan, the Note, the Deed of Trust and the other Loan Documents (such Loan Documents being described in the Modification Agreement), as modified by the Modification Agreement; (vii) acknowledges that there are no claims, counterclaims, offsets or defenses to or against its Guaranty or to its Guaranteed Obligations; (viii) certifies that the representations and warranties contained in its Guaranty remain true and correct as of the date hereof; (ix) acknowledges (jointly and severally) that Lender has satisfied and performed its covenants and obligations under the Loan Documents (if any), and that no prior action or failure to act by or on behalf of Lender has or will give rise to (A) any waiver by Lender of such Guarantor to pay and perform its obligations in strict compliance with the terms in its Guaranty, or (B) any cause of action or other claim against Lender for breach of the Loan Documents or otherwise; and (x) acknowledges and consents (jointly and severally) to the terms of any and all prior modifications to the terms of the Loan and the Loan Documents, including, without

[202] *See* annotation to Section 3.1(a)(viii) (Certain Agreements and Additional Waivers by Guarantor), *supra*.

limitation, any and all prior extensions of the term of the Loan and any and all prior increases in the principal amount of the Loan, if any.

This Consent is executed for the benefit of Lender, its successors and assigns, and any subsequent holder(s) of the Note, and is given as a material inducement to Lender to execute and deliver the Modification Agreement. Each Guarantor acknowledges that its execution of this Consent is a condition precedent to Lender's execution and delivery of the Modification Agreement, that Lender is relying on this Consent in entering into the Modification Agreement, and that Lender would not enter into the Modification Agreement without this Consent.

THIS CONSENT SHALL BE GOVERNED BY AND CONSTRUED IN ACCORDANCE WITH THE LAWS OF THE STATE OF TEXAS.

EXECUTED on the date(s) set forth in the acknowledgment(s) below but made to be EFFECTIVE as of the ____ day of ____, 20___.

GUARANTOR:

_________________________,
a_________________________

By:____________________________
Name: _________________________
Title: _________________________

STATE OF TEXAS §
§
COUNTY OF ___________ §

This instrument was ACKNOWLEDGED before me on ______________, 20___, by ____________________________________. **[CONFORM TO INDIVIDUAL OR ENTITY]**

____
Notary Public, State of Texas

My Commission Expires:

____
Printed Name of Notary Public

____

Rider 7

EXCLUSION OF CERTAIN GUARANTOR ASSETS

Add the following as a new Section in the Guaranty:

[____ Excluded Assets.[203] Notwithstanding any term or provision of this Guaranty to the contrary, Lender may not collect or satisfy any of the Guaranteed Indebtedness from, or enforce any of the Guaranteed Indebtedness against, all or any

[203] Unlike corporations, individual guarantors in Texas benefit from specific exemptions for certain real and personal property. Pursuant to Section 41.001 *et seq.* of the Texas Property Code and the Texas Constitution, an individual or family is entitled to an urban homestead of not more than one acre together with any improvements without reference to value. Alternatively, a family is entitled to a rural homestead of not more than 200 acres which may be in one or more parcels with improvements thereon and a single, adult individual, not otherwise entitled to a homestead, any claim not more than 100 acres which may be in one or more parcels with improvements thereon. *See* TEX. PROP. CODE ANN. § 41.002(a) & (b) (West 2010). Additionally, certain types of personal property are exempt from garnishment, attachment, execution, or other seizure. *See* TEX. PROP. CODE ANN. § 42.001. Unless encumbered by a security interest or a lien fixed by law, a family is entitled to claim exempt personal property in the categories listed in Section 42.002 of the Texas Property Code up to an aggregate fair market value of not more than $60,000 exclusive of the amount of any lien, security interest, or other charges encumbering the property, and a single adult who is not a member of a family is entitled to an aggregate fair market value of not more than $30,000 exclusive of the amount of any lien, security interest, or other charges. *See* TEX. PROP. CODE ANN. § 42.001(a)(1) & (2). Exempt items subject to the fair market value limits set forth in Section 42.001 of the Texas Property Code include home furnishings, provisions for consumption, farming or ranching vehicles, implements, tools, equipment, books, boats and motor vehicles used in trade or profession, wearing apparel, jewelry (not to exceed 25% of the aggregate limitations), two fire arms, athletic and sporting equipment including bicycles, a two-wheel, three-wheel or four-wheel motor vehicle for each member of a family or single adult who holds a driver's license or who does not hold a driver's license, but relies on another person to operate the vehicle for the benefit of the non-licensed person, two horses, mules or donkeys, and a saddle, blanket, bridle for each, 12 head of cattle, 60 head of other types of livestock, 120 fowl, and household pets. *See* TEX. PROP. CODE ANN. § 42.002 (a) & (b). Also exempt from execution, but not subject to the $30,000 limit for single adults or the $60,000 limit for a family, is a person's right to the assets held in or the right to receive payments, whether vested or not, under any stock, bonus, pension, profit sharing or similar plan, including retirement plans for self-employed individuals and under any annuity or similar contract purchased with assets distributed from that type of plan and under any retirement, annuity, or account described by § 403(b) or 408(a) of the Internal Revenue Code and under any individual retirement account or any individual retirement annuity including a simplified employee pension plan. *See* TEX. PROP. CODE ANN. § 42.0021. Contributions to any such plan are exempt provided that the contribution does not exceed the amount deductible under the applicable provisions of the Internal Revenue Code. *See* TEX. PROP. CODE ANN. § 42.0021. Furthermore, all current wages, alimony and child support and unpaid commissions (not to exceed $7,500 for a single adult or $15,000 for a family) are exempt from seizure, and all professionally prescribed health aids are exempt without reference to value. *See* TEX. PROP. CODE ANN. § 42.001 (b) & (d).

New federal legislation is currently being considered which, if passed, may affect state law exemptions in bankruptcy. Such legislation likely would impact only the availability to exemptions if the guarantor is in bankruptcy.

Also note that if the guarantor's spouse is not a party to the guaranty, or has not otherwise consented to the transaction, it is important to understand that the spouse's separate property and the spouse's sole management community property may, in effect, constitute an "Excluded Asset." *See* TEX. FAM. CODE ANN. § 3.202 (West 2010). *Cf.* third annotation on Signature Page [Joinder of Spouse], *supra*.

portion of those assets or items of property of Guarantor described on Exhibit __ attached hereto and incorporated herein by this reference, or any proceeds derived from the sale or liquidation thereof.]

Add an Exhibit to the Guaranty detailing the Excluded Assets.[204]

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[204] The parties may expressly specify that (in addition to assets that may be excluded by applicable law as discussed in the preceding annotations in this Rider 7) certain assets be excluded from collection or satisfaction of the Guaranteed Obligations in connection with the exercise of any remedies that may be available to Lender (such as attachment, levy, or garnishment). Such excluded assets may include, for example, certain items of personal property (such as automobiles, jewelry, artwork, household furnishings, or stock/ownership interests in a corporation or partnership) owned by the guarantor. If the guarantor requests that certain assets be excluded, the lender should carefully examine in its underwriting process which assets would be excluded and should require that the guarantor maintain certain and sufficient assets throughout the term of the loan.