Should You Be a Guarantor?

By Andrew M. Fallek, Esq.\*

In today’s uncertain economy, skittish lenders and landlords do not hesitate to ask for a personal guaranty from a third-party as a condition of making a loan or entering into a commercial or residential lease. That’s often the case even where the principal has good credit, a well-paying job and money in the bank. As a result, many people will be asked by family members or close friends to be a guarantor.

***What is a Guaranty?***

One who signs a guaranty agrees to be financially responsible for the debt or contractual responsibility of another person or another entity, such as a business. By obtaining a guaranty, one party to an agreement seeks to obtain some additional level of assurance that the contemplated transaction will be completed in accordance with its terms. If the principal stops paying, the lender or landlord will look to the guarantor for performance.

The sought after added assurance may be real, especially where the guarantor is a wealthy individual, or it may be illusory, as where an individual or even a business guarantor has no assets. It’s why you need to examine the financials of the guarantor if you are truly going to rely on them for payment if things go badly.

***What are My Risks as a Guarantor?***

It is sometimes said that as a practical matter, a guarantor should consider him or herself as a co-signer of the original obligation; which is to say, one who will be principally responsible under the agreement. After all, if your son or daughter tells you they cannot pay their rent, you will probably cut the check without waiting to hear from the landlord. While it is generally true that a guarantor will probably never be contacted if the principal pays on time in accordance with the agreement, today’s guarantees may actually place the guarantor in a worse position than the primary party to the loan or lease, and, as explained below, make the guarantor a more attractive target for collection efforts than the principal.

**A Separate Agreement**

Although the guarantee may be found appended to the end of a loan document or lease given to the borrower or tenant for signature, "a guarantee agreement is separate and distinct from the contract between lender and borrower”[[1]](#footnote-1) and its terms may be interpreted separate and apart from the underlying agreement between the two principals. This has significant ramifications for the guarantor.

With some stylistic variation, a typical guaranty will contain some or all of the following language:

This Guaranty is an irrevocable, **absolute and unconditional** present and

continuing guaranty of payment, and not of collection. It shall be enforceable

against Guarantor, upon written demand, **without the necessity of suit or**

**other proceedings**.

**Guarantor waives** presentment, demand, protest, **notice of non-payment**

Or protest thereof, **notice of default**, notice of acceptance of this guaranty,

notice of intent to accelerate, **notice of acceleration**, any notices of any kind

in connection with this guaranty, **any right of setoff, and any defenses which**

**could be raised**, to the maximum extent permitted by applicable law

(emphasis added).

The foregoing language has consistently been interpreted in New York to mean the guarantor waives all defenses which could be raised by the principal, including defenses which are generally always available to a party to a contract, such as fraud in the inducement.[[2]](#footnote-2) In fact, where a guaranty unconditionally imposes liability on the guarantor, the guarantor may be held liable even if the principal escapes liability entirely.[[3]](#footnote-3)

Similarly, when the above language is utilized courts have repeatedly held that the party holding the guaranty is under no obligation to pursue other remedies, such as a suit against the borrower, prior to demanding money from, or commencing an action, against the guarantor. [[4]](#footnote-4)

The above language also refers to another potential pitfall for the guarantor, “acceleration.” Most guarantors probably expect that they can limit their financial exposure by making the one or more missed monthly payments to bring the loan current. But what if the guarantor doesn’t know that a loan is already seriously in default (you’ve waived notice of non-payment as part of the guaranty agreement) and that all the payments due under the loan or the lease (plus other fees) have been “accelerated” and are due immediately? The guarantor could be on the hook for the entire balance.

Waiving notice of the non-payments may not constitute a major issue when your personal guaranty is made for a loan that is made to a company you actively run – you will know if a payment has been missed – but it’s an entirely different story when you guaranty a personal loan to someone else (a relative or close friend) who is unlikely to call you if he or she misses a number of payments (“sorry, I didn’t let you know earlier because I thought I would have all the money together soon and I spoke to the landlord about it”).

***Conclusion***

By now, you should have recognized that guaranteeing a loan or a lease can have devastating consequences for the guarantor and the best advice is to avoid signing one if possible. If the other party is concerned about the financial risk, try offering them something that provides alternative protection, like a larger security deposit (in the case of a lease). Perhaps they will agree to a personal guarantee for a year or two, rather than the entire term of the agreement? One option is a so-called “good guy” guarantee, often used in commercial leases, in which you guaranty the rent until such time as the tenant vacates the premises (the tenant may remain liable under the lease but the guarantor ‘s liability ceases when the space is returned to the landlord). Or maybe you would rather be listed as a joint obligor. At least you will retain certain legal defenses. If all else fails, at the very least try negotiating to remove the notification waiver provisions and require the other party to send copies of notices concerning breaches of the agreement directly to you. Such a provision may involve you far more than you ever envisioned, but it will give you a chance to intercede to avoid more onerous financial problems.

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1. *Kinville v. Jarvis Real Estate Holdings, LLC,* 38 A.D.3d 1225, 1227, 833 N.Y.S.2d 773 (4th Dep’t 2007) [↑](#footnote-ref-1)
2. *Citibank v. Plapinger*, 66 N.Y.2d 90 (1985). [↑](#footnote-ref-2)
3. *Gard Entertainment, Inc. v Country in N.Y., LLC*, 96 A.D.3d 683, 683-684, 948 N.Y.S.2d 42 (1st Dep’t 2012). [↑](#footnote-ref-3)
4. *Milliken & Co. v. Stewart*, 182 A.D.2d 385, 386-387, 582 N.Y.S.2d 127 (1st Dep’t 1992). [↑](#footnote-ref-4)