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PERSPECTIVE

Case shows how coasts differ on guarantor obligations

By Kimberly A. Chi

A recent 2nd U.S. Circuit Court of Appeals case serves as a reminder that California and New York law can differ with respect to the enforceability of waivers of defenses by a guarantor. In *136 Field Point Circle Holding Co., LLC v. Invar Intern Holding, Inc.*, 644 F. App'x 10 (2d Cir. 2016), pursuant to a summary order (which does not have precedential effect), the court affirmed the lower court's decision to enforce the obligation of a guarantor of a lease to pay liquidated damages to the landlord regardless of whether the damages were enforceable against the tenants.

The lease underlying the guaranty provided for the payment by the tenants of monthly rent of \$25,000 and required the tenants to pay \$1 million to the landlord if they did not vacate the property (a waterfront mansion) at the end of the term. The lease was guaranteed by an entity owned by the tenants and their daughter, and the guaranty provided that the obligations thereunder were "absolute under any and all circumstances, without regard to the validity, regularity or enforceability of the [lease]."

The tenants did not vacate the property at the end of the term and the tenants and the guarantor refused to make the holdover payment. Despite the fact that the parties apparently stipulated that the obligation of the tenants to make this payment was an unenforceable penalty, the lower court held the guarantor to the terms of the guaranty, pointing out that "[i]t is a clearly estab-

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The lower court held the guarantor to the terms of the guaranty, pointing out that "[i]t is a clearly established principal that '[a]bsolute and unconditional guaranties ... [can] preclude guarantors from asserting a broad range of defenses under New York law.'"

lished principal that '[a]bsolute and unconditional guaranties ... [can] preclude guarantors from asserting a broad range of defenses under New York law'" (quoting *Compagnie Financiere de CIC et de L'Union Europeenne v. Merrill Lynch, Pierce, Fenner & Smith Inc.*, 188 F.3d 31, 35 (2d Cir. 1999)). The language of the guaranty "clearly and unambiguously require[d] [the guarantor] to make payment regardless of whether or not the primary obligation [was] enforceable."

On appeal, the 2nd Circuit agreed that it did not matter whether the obligation to make the holdover payment was enforceable and suggested that a guaranty purporting to be "absolute and unconditional" affords a guarantor almost no defense to its obligations ("broad, sweeping and unequivocal language" in an absolute and unconditional guaranty generally "forecloses any challenge ... to any ... possible defense to ... liability for the obligations" (quoting *Coöperatieve Centrale Raiffeisen-Boerenleenbank, B.A., "Rabobank Intl." N.Y. Branch v. Navarro*, 25 N.Y.3d 485, 494 (2015))).

Neither court explained the rationale for honoring a waiver in a guaranty of the lack of en-

forceability of the underlying lease obligation to pay liquidated damages when such a waiver by the tenants (i.e., the party primarily responsible) would not have been enforceable. In light of this inconsistency, a California court may reach the opposite conclusion.

California law, by statute, permits guarantors to waive a range of defenses that otherwise would be available (*see* Cal. Civ. Code Section 2856(a)(1): "any guarantor ... may waive ... [its] rights of subrogation, reimbursement, indemnification, and contribution and any other rights and defenses that are or may become available to the guarantor ... by reason of [California Civil Code] Sections 2787 to 2855"). Such rights and defenses include those arising under Sections 2809 and 2810 of the Civil Code, which generally provide that a guarantor's obligations will not be greater than those of the principal. However, there are limits on the defenses a guarantor may waive (*see, e.g., Cal. Bank & Trust v. DelPonti*, 232 Cal. App. 4th 162 (2014): "we do not read Civil Code section 2856 to permit a lender to enforce [the waivers in the guaranty] beyond those specified [in the Civil Code], where to do so would result in the lender's un-

just enrichment, and allow the lender to profit from its own fraudulent conduct.").

WRI Opportunity Loans II LLC v. Cooper, 154 Cal. App. 4th 525 (2007) is a useful analogy to *Field Point Circle*. *WRI* involved a guaranteed loan that the court determined was usurious. The guarantied party argued that the guarantors waived, under the terms of the guaranty, the right to assert usury of the underlying obligation as a defense to the guaranty.

Pointing out that the "usurious provisions of a loan are void on the grounds of illegality or unlawfulness because they violate express provisions of law," the court sided with the guarantors. Although the guaranty purported to be "absolute and unconditional," the court did not focus on this language and instead analyzed the waivers in the guaranty. Stating that "the usury defense rests on the rule against the enforcement of illegal transactions," the court distinguished statutory defenses that provide that a guarantor's obligations may not be greater than that of the principal (i.e., Cal. Civ. Code Sections 2809 and 2810) from a defense based on the illegality of the underlying obligation. The court decided that Section 2856

of the California Civil Code permits a waiver of the former but not the latter.

California law treats liquidated damages in a residential lease such as the one in *Field Point Circle* as void under Section 1671(d) of the California Civil Code, though an exception may apply if it would be impracticable or extremely difficult to fix actual damages. While an agreement to pay increased rent following the end of a lease term may be permissible under California law and not treated as liquidated damages (see *Vucinich v. Gordon*, 51 Cal. App. 2d 434 (1942)), a requirement to pay \$1 million regardless of the hold-over period, where monthly rent was \$25,000 during the term, could very well be held to be unenforceable by a California court.

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Because the invalidity of liquidated damages under a residential lease under California law arises under statute, such liquidated damages are illegal. See, e.g., *Cook v. King Manor and Convalescent Hosp.*, 40 Cal. App. 3d 782 (1974), which examined a predecessor to Section 1671(d): “[s]ince an illegal contract [i.e., a contract providing for unenforceable liquidated damages] is void ... no person can be estopped to deny its validity;” and Cal. Civ. Code Section 3513 (“a law established for

a public reason cannot be contravened by a private agreement”). As a result, in light of *WRI*, a California court may disagree with the *Field Point Circle* courts that a guarantor could effectively waive the invalidity.

New York is the chosen governing law by many if not most commercial lenders and other guarantied parties, and *Field Point Circle* demonstrates that guarantors should be mindful of the breadth of the waivers to which they agree. For their part, guarantied parties need to be

aware that the choice of California as the governing law can negatively affect the strength of the waivers in a guaranty.

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