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Practice Area: Banking and Commercial Finance

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In commercial transactions, the personal guaranty from the equity holder of the borrower is a standard request by banks and other lenders. Often, these guaranties are executed as part of a larger closing, and without the consideration warranted for such an important document.

Banks and other lenders seek guaranties for two purposes. The first and obvious purpose is to secure additional assets for the loan. Of even more importance to the lender is the second purpose: a guaranty assures the cooperation of the borrower's principals if the borrower should default.

With the economic downturn, and the loss of millions of dollars of perceived value in real estate, guaranties have become a critical component of the lender's efforts for realization on its defaulted loans.

In 2010, the Wisconsin Supreme Court decision *Bank Mutual v. S.J. Boyer Constr., Inc.* confirmed that the rights and obligations of a guarantor are separate and distinct from those of the borrower because the guarantor's obligations arise from the terms of the guaranty contract.<sup>1</sup> This July, the Wisconsin Supreme Court handed down a landmark decision on guarantor liability in *Park Bank v. Westburg*,<sup>2</sup> which confirmed the court's premise in *S.J. Boyer Constr., Inc.* that the guaranty contract is a separate contract, and further confirmed that the parties are bound by the language of that contract.

### **The Facts**

In *Westburg*, Park Bank filed a lawsuit seeking payment under two continuing guaranty contracts. The guarantors, Roger and Sandra Westburg, counterclaimed against Park Bank. The Westburgs' claims were based upon the following alleged actions by Park Bank:<sup>3</sup>

- failing to provide the borrower with sufficient time to establish itself and become profitable;
- refusing to authorize or honor payments to the borrower's creditors;
- forcing the borrower to enter into a Chapter 128 receivership;
- establishing unrealistic financial covenants to intentionally cause a default;
- controlling the management of the borrower; and
- freezing the Westburgs' personal account unlawfully.

In addition, the Westburgs set forth numerous affirmative defenses, including:

- failure to state a claim upon which relief could be granted;
- estoppel;
- breach of contract;
- duress;
- failure to properly marshal assets and remedies;
- laches;
- failure to provide sufficient service of process; and
- failure to mitigate damages.

The Circuit Court of Walworth County granted summary judgment in favor of Park Bank, and the Wisconsin Court of Appeals and Wisconsin Supreme Court affirmed. Specifically, the court found that the Westburgs lacked standing to raise the counterclaims because they were derivative, and that the Westburgs' affirmative defenses were insufficient to defeat Park Bank's demand for payment under a guaranty of payment.

### **Standing**

In Wisconsin, the legal right to redress an injury to a corporation belongs to the corporate entity. A shareholder cannot maintain a direct action for an injury to the corporation, unless he or she also suffers a direct injury and is independently damaged. If the injury to the shareholder is only secondary, the shareholder lacks standing to raise a claim to recover for himself or herself "on account of injury done to the corporation."

In *Westburg*, the court analogized guarantors to shareholders, and concluded that "**a guarantor lacks standing to raise derivative claims (claims deriving from an injury to the borrower) against a creditor.**" The Wisconsin Supreme Court noted that courts should determine whether the guarantor has standing to bring a claim by focusing on "[w]hose right is sought to be enforced" by the guarantor's action, and determine "whether [the] claim is direct, derivative, or both." The court also found that Park Bank's conduct toward the borrower "before, during, and after [the borrower] entered receivership" constituted the primary injury and that any injury to the Westburgs was secondary and derivative. As a result, the court dismissed almost all of the counterclaims. The only counterclaim that the court allowed was a claim for the unlawful denial to the guarantors' personal bank accounts, because such action directly injured the Westburgs and not the borrower.

### **Affirmative Defenses**

The guaranties in the *Westburg* case were guaranties of payment, and provided by their terms that payment is required "when due or, to the extent not prohibited by law, at the time any Debtor becomes the subject of bankruptcy or other insolvency proceedings." The court pointed out that guaranties of payment are different from other guaranties—such as guaranties of collection—in that a guaranty of payment "binds the guarantor to pay the debt according to the terms and conditions of the guaranty," regardless of whether the creditor exhausts remedies against the borrower or other guarantors.

The court found that "[i]n order to demand payment under the guaranties, Park Bank need show only that payment is due or that any debtor has become the subject of a bankruptcy or insolvency proceeding." **Accordingly, the only defenses available to a guarantor of payment "must logically address whether payment is due or whether [the borrower] has become the subject of a bankruptcy or insolvency proceeding."**

### **Impact of the Westburg Case**

The impact of the decision in *Westburg* is significant. A creditor need only show that payment is due (or that that the borrower became the subject of an insolvency proceeding) in order to obtain judgment, if the guaranty so provides. Moreover, the *Westburg* decision confirms that a creditor's inaction or action with regards to a borrower, other guarantors, or any collateral does not affect the liability of a guarantor of payment or provide a basis for a claim by a guarantor against a creditor. *Westburg* affirms the importance of the guaranty contract, confirms that the language of the contract controls, and further affirms the distinction between guaranties of payment and guaranties of collection. The decision in *Westburg* gives the lender a strong lever when addressing workouts and in pursuing guarantors.

<sup>1</sup> 2010 WI 74, ¶ 54, 326 Wis.2d 521, 785 N.W.2d 462.

<sup>2</sup> 2013 WI 57, 348 Wis.2d 409, 832 N.W.2d 539. Unless otherwise indicated, all quotations are from *Westburg*.

<sup>3</sup> *Park Bank v. Westburg*, No. 2010AP3158, 2012 WL 385507 (Wis. Ct. App. Feb. 8, 2012). The court of appeals decision provides a detailed discussion of these actions.

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