Ideas for Teaching Transactional Skills

Presented by

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Transactional Skills Exercise – Annotating a Form

You represent the bank that uses the form guaranty on the next page. Annotate each of the four highlighted clauses. In other words, for each highlighted sentence or phrase, identify its purpose, explain why it is or is not necessary, and explain how, if at all, it should be revised. Before doing this, review the example of an annotated form that will be distributed electronically and then consult whatever legal authorities you deem relevant. Do not merely intuit the answer; you will need to research the law to complete this exercise.

GUARANTY AGREEMENT

[Identification of parties, recitals, definitions]

* * *

1. ***Obligations Guarantied.*** Guarantor hereby guarantees to Creditor the final and full payment in cash of the Guarantied Obligations. This is a guaranty of payment and not merely of collection. In addition, Guarantor will be liable to for and shall pay Creditor all costs and expenses including, reasonable attorney's fees, incurred by Creditor in enforcing the obligations of Guarantor under this Agreement.

2. ***Nature of Guaranty.*** The obligations of the Guarantor under this Guaranty Agreement are continuing, absolute, unconditional and irrevocable.

3. ***Waivers.*** To the fullest extent permitted by law, Guarantor waives: * * *

4. ***Revival and Reinstatement.*** If any payment of a Guarantied Obligation or any transfer by Borrower or Guarantor to Creditor of any property should for any reason subsequently be declared to be void or voidable under any state or federal law relating to creditors' rights, (collectively, a "Voidable Transfer"), and if Creditor is required to repay or restore, in whole or in part, any such Voidable Transfer, then, as to any such Voidable Transfer, or the amount thereof that Creditor is required to repay or restore, and as to all reasonable costs, expenses, and attorney's fees of Creditor related thereto, the liability of the Guarantor will automatically be revived, reinstated, and restored and will exist as though such Voidable Transfer had never been made.

5. ***Successors and Assigns.*** This Agreement will be binding on the heirs, administrators, and representatives of Guarantor and will inure to the benefit of the successors and assigns of Creditor.

6. ***Choice of Law.*** This Agreement is governed by and is to be interpreted under the law of the State of California

7. ***Waiver of Right to Jury.*** Guarantor hereby waives Guarantor's rights to a jury trial of any claim or cause of action based on, arising out of, or relating to this Agreement, the Guarantied Obligations, or any of the transactions contemplated herein, including contract claims, tort claims, breach of duty claims, and all other common law or statutory claims.

8. ***Entire Agreement.*** This Agreement constitutes the entire agreement between the Guarantor and Creditor pertaining to the subject matter contained herein.

Materials Relevant to Clause 1

Restatement (Third) of Suretyship & Guaranty

§ 15. Interpretation Of The Secondary Obligation – Use Of Particular Terms

Unless indicated to the contrary by applicable law, the language employed by the parties, agreement of the parties, or the context:

* * *

(b) if the parties to a contract identify one party as a "guarantor of collection" or the contract as a "guaranty of collection," the party so identified is a secondary obligor and the secondary obligation is, upon default of the principal obligor, to satisfy the obligee's claim with respect to the underlying obligation, if:

(1) execution of judgment against the principal obligor has been returned unsatisfied; or

(2) the principal obligor is insolvent or in an insolvency proceeding; or

(3) the principal obligor cannot be served with process; or

(4) it is otherwise apparent that payment cannot be obtained from the principal obligor;

Materials Relevant to Clause 2

Restatement (Third) of Suretyship & Guaranty

§ 6. Rules Subject To Agreement Of Parties

Each rule in this Restatement stating the effect of suretyship status may be varied by contract between the parties subject to it.

§ 8. When Notification Of Acceptance Of The Secondary Obligor's Offer Is Necessary For Creation Of The Secondary Obligation

(1) Unless the secondary obligor's offer to enter into the secondary obligation contains a request for notification of acceptance, the obligee need not give such notification where either:

(a) the offer invites the obligee to accept by extending credit to or contracting with the principal obligor; or

(b) under the circumstances of the offer, extending credit to or contracting with the principal obligor is a reasonable mode of acceptance by the obligee.

Otherwise, notification of acceptance of the secondary obligor's offer is necessary for creation of the secondary obligation to the extent required by the law of contracts.

(2) If an obligee who accepts by extending credit to or contracting with the principal obligor has reason to know that the secondary obligor has no adequate means of learning of such acceptance with reasonable promptness and certainty, the secondary obligation is discharged after a reasonable time unless:

(a) the obligee exercises reasonable diligence to notify the secondary obligor of acceptance; or

(b) the secondary obligor learns of such acceptance within such time; or

(c) the offer indicates that notification of acceptance is not required.

Comment:

a. *Notice to secondary obligor.* An offer to become a secondary obligor commonly invites the offeree to accept by advancing money, goods, or services on credit. Notification is not essential to acceptance of such an offer, and often is not necessary at all. Subsection (2), however, may require notification unless the offer manifests a contrary intention. Notification is required by subsection (2) only where the secondary obligor has no adequate means of ascertaining whether the advance has taken place. Even then, it is not the notification that creates the secondary obligation, but lack of notification that discharges it. An offer of guaranty that does not require notification is often called an “absolute guaranty.”

§ 16. Continuing Guaranty

A continuing guaranty is a contract pursuant to which a person agrees to be a secondary obligor for all future obligations of the principal obligor to the obligee. A continuing guaranty is terminable, and may be terminated by the continuing guarantor by notice to the obligee. If the continuing guarantor is a natural person, the continuing guaranty is terminated by the death of the continuing guarantor unless the continuing guaranty provides otherwise. Upon termination of a continuing guaranty, the continuing guarantor remains a secondary obligor with respect to obligations of the principal obligor incurred prior to termination and becomes a secondary obligor with respect to obligations of the principal obligor incurred by extensions of credit to the principal obligor after termination pursuant to a commitment that became binding before termination. Otherwise, the continuing guarantor does not become a secondary obligor with respect to any obligations incurred by the principal obligor after termination.

Comment:

a. *General principle.* A person can agree to become a secondary obligor for subsequent obligations of another person. While in some cases, such an agreement is for specific, identifiable obligations that are planned for the future, it is also possible for a person to agree to a more open-ended obligation pursuant to which unspecified future obligations are covered. Such an agreement is usually called a "continuing guaranty," although it need not be so denominated. While a continuing guaranty is sometimes described as a series of offers to become a secondary obligor, each of which is accepted by extension of new credit by the obligee, that description does not accord with the likely intent of the parties and is not necessary for a legal conceptualization of the agreement. Rather, it is more accurate to describe, as this section does, the agreement between the secondary obligor and the obligee as a present contract. See, however, § 12(6). Under that contract, the continuing guarantor agrees to serve as a secondary obligor for all future extensions of credit to the principal obligor until the guaranty is terminated. Upon termination, the secondary obligor remains liable with respect to underlying obligations already incurred, but does not become a secondary obligor for future extensions of credit.

Illustrations:

1. To induce C to enter into a credit relationship with D, G enters into a continuing guaranty of all of D's obligations to C. G will be a secondary obligor with respect to all obligations of D to C that are entered into before termination of the continuing guaranty.

2. To induce C to enter into a credit relationship with D, on March 28 G enters into a continuing guaranty of all of D's obligations to C. C loans D $1,000 on each of April 6, July 5, and July 9. On August 7, G terminates the continuing guaranty. On August 11, C loans D an additional $1,000. C defaults on all four obligations. G is liable for the loans made on April 6, July 5, and July 9, but is not liable for the loan made on August 11.

b. *Termination of continuing guaranties.* Termination of a continuing guaranty refers only to termination of liability with respect to subsequent extensions of credit. As described in Comment a, after termination the continuing guarantor remains liable with respect to extensions of credit that were made prior to termination. Unless the guaranty specifies to the contrary, termination can be accomplished by means of notice to the obligee, and occurs automatically without the necessity of notice upon the death of the continuing guarantor.

c. *Agreement to maintain continuing guaranty after death of guarantor.* Under some circumstances, it may be to the advantage of the continuing guarantor's interests to agree that the continuing guaranty will not terminate upon the death of the continuing guarantor. For example, if death of the guarantor were to terminate the continuing guaranty of a revolving line of credit established on behalf of the guarantor's business, the creditor would likely terminate the line of credit upon the guarantor's death. The result could well be to necessitate the shutdown of the business, a result that would not be advantageous to the beneficiaries of the guarantor's estate. In such a case, the beneficiaries would probably be better off if the estate of the guarantor remained liable for extensions of credit under the revolving line of credit. This section, therefore, provides that the obligee and guarantor may agree that the continuing guaranty will not terminate automatically upon the guarantor's death. Of course, the executor or administrator of the estate would retain the power to terminate the continuing guaranty. It should be noted that the statement, common in guaranties as well as other contracts, that the guaranty is binding on the heirs and other successors of the guarantor, does not, in itself, create such an agreement; rather, it simply reinforces the effect on those successors of the obligations incurred prior to the automatic termination.

§ 48 Waiver of Suretyship Defenses; Consent

* * *

Comment

d. *Waiver of suretyship defenses.* Another mechanism that is commonly used to avoid discharges resulting from impairment of recourse is for the secondary obligor to forego, by agreement or waiver, the benefit of rules in §§ 39-44 that might otherwise result in such discharges. This may be accomplished in the contract creating the secondary obligation or otherwise. Some indication that suretyship rights are being foregone is required; thus, a statement to the effect that the duty of the secondary obligor is absolute or unconditional is ordinarily not sufficient to indicate that the secondary obligor is agreeing to forego discharges based on suretyship status.

Materials Relevant to Clause 4

Restatement (Third) of Suretyship & Guaranty

§ 70. When Obligation Of Secondary Obligor Revives

When a secondary obligation is discharged in whole or part by performance by the principal obligor or another secondary obligor, or by realization upon collateral securing such performance, the secondary obligation revives to the extent that the obligee, under a legal duty to do so, later surrenders that performance or collateral, or the value thereof, as a preference or otherwise.

Comment:

a. *General principle.* The obligee is entitled to only one performance. *See* § 1. Therefore, generally speaking, the secondary obligor is discharged with respect to the obligee to the extent of performance by the principal obligor or another secondary obligor. If that performance (whether voluntary or pursuant to agreement or judgment) is later set aside, and the obligee must surrender that performance or its value, the obligee is in the same position as though there had been no performance. Had there been no performance, however, the obligee would have a claim against the secondary obligor. Thus, this section revives the obligee's claim against the secondary obligor in order to complete the obligee's return to the position in which it would have been had there been no performance.

b. *Preferences.* The principle embodied in this section has its most common application in the law of preferences. When an obligee receives a payment from an insolvent obligor, and, because the payment is later held to constitute a preference, the obligee must return the payment or its value to the bankruptcy trustee, the obligee is put into the same position as though the payment had never been made. Therefore, this section revives the obligee's claim against the secondary obligor. If this were not the case, and the claim against the secondary obligor, having been discharged by the principal obligor's payment, did not revive, the result would not necessarily be favorable to secondary obligors. After all, an obligee would be reluctant to accept payment from a financially distressed principal obligor when there is available an action against a solvent secondary obligor because, if the payment later were held preferential, the obligee would have no recourse against the secondary obligor. To avoid such an inopportune situation, the obligee would have a strong incentive to proceed initially against the secondary obligor rather than accept payment from the principal obligor. As a result, in the absence of the rule set forth in this section, secondary obligors might well be called upon to perform more often rather than less often.

Illustration:

1. P borrows $1,000 from C. P's repayment obligation is guaranteed by S. P repays the debt on July 9, discharging S. On August 11, P files a bankruptcy petition. P's repayment of the loan is later determined to constitute a preference, and the trustee recovers the amount of the payment from C. S's obligation on the guaranty revives.

c. *Rule not applicable to voluntary return of payment.* If the obligee returns performance received from the principal obligor when not required to do so by law, the rule in this section does not apply. In such a case, the obligee has taken an action that is essentially equivalent to refusing performance tendered by the principal obligor. Such a refusal of tendered performance discharges the secondary obligor pursuant to § 46. By not reviving the secondary obligation in the case of voluntarily returned performance, this section does not disturb the discharge originally brought about by the principal obligor's performance.

Materials Relevant to Clause 7

Grafton Partners L.P. v. The Superior Court of Alameda County
Supreme Court of California (2005)

George, C.J.

The present case concerns what is principally a question of statutory interpretation. At issue is Code of Civil Procedure section 631, a provision prescribing the six means by which parties to a civil lawsuit may waive their right to have their disputes adjudicated in a jury trial rather than in a court trial. Petitioners contend a contractual agreement that is entered into prior to any dispute arising between the contracting parties is not one of the means authorized by statute. In consequence, they claim, their predispute agreement that any lawsuit between them and real party would be adjudicated in a court trial, and not by jury trial, was unenforceable. The Court of Appeal agreed with petitioners' contention, as do we, for the reasons that follow.

I

In March 1999, petitioners engaged real party in interest PriceWaterhouseCoopers L.L.P. (hereafter real party), an accounting firm, to audit certain accounts belonging to two of petitioners' partnerships, Grafton and Allied. On March 11, 1999, real party sent petitioners an engagement letter confirming the terms of the retainer agreement. Under the heading "[r]elease and indemnification," the letter released real party from liability in the event of misrepresentation by the partnerships' management and specified that real party would not be liable to the partnerships except for willful misconduct or fraud. A waiver followed, expressed in these terms: "In the unlikely event that differences concerning [real party's] services or fees should arise that are not resolved by mutual agreement, to facilitate judicial resolution and save time and expense of both parties, [petitioners and real party] agree not to demand a trial by jury in any action, proceeding or counterclaim arising out of or relating to [real party's] services and fees for this engagement." On June 27, 2002, petitioners filed a complaint against real party, alleging negligence, misrepresentation, and other causes of action based upon real party's asserted failure to disclose and its cover-up of fraudulent business practices that it discovered during its audit * * * and petitioners demanded a jury trial. The trial court, relying upon the waiver contained in the engagement letter, granted real party's motion to strike the jury demand. * * *

II

When parties elect a judicial forum in which to resolve their civil disputes, article I, section 16 of the California Constitution accords them the right to trial by jury (with limited exceptions not relevant in the present case). * * *

The statute implementing this constitutional provision is section 631. It holds inviolate the right to trial by jury, and prescribes that a jury may be waived in civil cases *only* as provided in subdivision (d) of its provisions. Subdivision (d) describes six means by which the right to jury trial may be forfeited or waived * * *, declaring: "A party waives trial by jury in any of the following

ways: (1) By failing to appear at the trial. (2) By written consent filed with the clerk or judge. (3) By oral consent, in open court, entered in the minutes. (4) By failing to announce that a jury is required, at the time the cause is first set for trial, if it is set upon notice or stipulation, or within five days after notice of setting if it is set without notice or stipulation. (5) By failing to deposit with the clerk, or judge, advance jury fees as provided in subdivision (b). (6) By failing to deposit with the clerk or judge, at the beginning of the second and each succeeding day's session, the sum provided in subdivision (c)."

Real party contends that subsection (2) of subdivision (d) permits persons to waive jury trial by contract prior to any legal dispute, so long as one of them, subsequently having become a party to litigation concerning the legal dispute, files the waiver with the clerk or judge. Real party asserts the provision does not restrict the time at which the waiver agreement may be entered into. * * * [O]ur decision in *Madden v. Kaiser Foundation Hospitals,* 552 P.2d 1178 (Cal. 1976), supports a contrary conclusion.

Madden, a party to a health care contract that contained an arbitration clause, relied upon section 631 in an effort to avoid arbitration of a dispute arising out of the contract. She asserted that the jury waiver contained in the arbitration clause was unenforceable because it failed to comply with section 631, yet resulted in the loss of the right to trial by jury.

This court disagreed, concluding that section 631 was more limited in its application than Madden claimed. Although an arbitration agreement results in the waiver of the right to jury trial, we concluded section 631 applied *only once litigation had commenced.* We said that the statute "*presupposes a pending action,* and relates only to the manner in which a party to such action can waive his right to demand a jury trial instead of a court trial. It does not purport to prevent parties from avoiding jury trial by not submitting their controversy to a court of law in the first instance. Indeed it has always been understood without question that parties could eschew jury trial either by settling the underlying controversy, or by agreeing to a method of resolving that controversy, such as arbitration, *which does not invoke a judicial forum.*"

In other words, it was our view that section 631 applies only once there is a pending action – once the parties have "submitt[ed] their controversy to a court of law." By inference, only persons who already *are parties to a pending action* may enter into a waiver of jury trial as provided by the statute.

* * * Real party objects, claiming the circumstance that section 631 "presupposes a pending action""does not mean that written consents cannot be prepared before the action is instituted and then filed in court during the pending action within the meaning of section 631(d)(2)." * * * We believe the language of section 631, subdivision (d) strongly suggests that waiver of the right to jury trial must occur subsequent to the initiation of a civil lawsuit. * * * [T]he grammar of section 631, subdivision (d) strongly supports the inference that both the agreement to waive jury trial and the filing of any such agreement must occur subsequent to the commencement of the lawsuit. * * *

Similarly, the circumstance that five of the six subsections of section 631, subdivision (d)

refer to an act or omission that, as a *temporal* matter, must occur *entirely* during the period following the commencement of litigation strongly suggests that the waiver described in subsection (2) also refers to an act that is undertaken entirely during the period after the lawsuit was filed. Specifically, a failure to appear, to demand jury trial, or to pay necessary fees – or an oral consent in open court – must occur in its entirety after the litigation has commenced. If the Legislature had intended a different temporal reach for section 631, subdivision (d)(2), we believe it would have explicitly stated so – as it did in connection with arbitration and reference agreements. * * *

Real party draws our attention to asserted anomalies created by the conclusion we reach. First, it points out that section 631 permits parties to forfeit the right to jury trial even if the forfeiture is caused by their own negligence in failing to file a timely demand for jury trial or their failure to deposit necessary fees in a timely manner. It would be anomalous, according to real party, to permit loss of the important right to jury trial through negligence, while prohibiting a knowing, voluntary, written waiver of the right entered into before any dispute has arisen between parties to a contract.

We do not believe our interpretation produces an anomalous result. The forfeiture provisions upon which real party relies were created by the *Legislature.* They form part of a considered procedural scheme intended to create a balanced adversarial system and a fair system of public administration of justice – a system that can be altered by legislation after due deliberation.

The Legislature evidently had confidence that the initiation of a lawsuit within the adversarial system would sufficiently focus the attention of the litigants to produce a considered decision whether to demand – and pay for – a jury trial based on an informed understanding of the stakes involved. * * *

Real party next questions why we would recognize the validity of arbitration agreements that are entered into in advance of any dispute – agreements that waive an entire package of trial rights – but balk at permitting a more limited waiver in the form of a predispute waiver of jury trial. The answer is readily apparent: the Legislature has enacted a comprehensive scheme *authorizing* predispute arbitration agreements, expressing a strong state policy favoring arbitration. * * *

The judgment of the Court of Appeal is affirmed.