Secured Transaction Guarantors in California: Is It Time to Reevaluate the Validity and Timing of Waivers of Rights

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SECURED TRANSACTION GUARANTORS IN CALIFORNIA: IS IT TIME TO REEVALUATE THE VALIDITY AND TIMING OF WAIVERS OF RIGHTS?

I. INTRODUCTION

For years your friends and family have complimented you and your spouse’s culinary skills. Again and again they admonish you to share the secrets of your wonderful cooking with the rest of the world by opening your own restaurant. Finally, after years of contemplation, you work up the nerve to follow the advice. At last, the perfect location has become available.

Upon investigating the available financing options for your venture, you find that you are unable to qualify for the necessary funds without some additional assurance for the lender. In the time it would take to amass enough additional capital, both the prime location and your nerve will have disappeared.

Calling upon one of the biggest fans of your edibles, your rich uncle, you discover that he would love to help, except for his tight cash flow. You inform him that all the lender would require is his signature on a guarantee agreement, which includes sections that describe the rights he would be waiving. Although he feels compelled to help you, he has one big concern. He wants to know what his liability to the lender would be should you and your spouse become unable to make the payments. Your neighbor is an attorney, so you stop by to put him to the test. After a couple of days he comes back to you frowning and confused.

An investigation of the legal rights involved in this situation could confuse any lawyer not well acquainted with California real property secured transaction law. The situation is especially complex where mixed collateral is involved, that is, where the guarantor is vouching for an obligation that is secured by both personal and real property. In the present case,

1. A guarantee agreement is “[a]n undertaking or promise that is collateral to a primary or principal obligation and that binds guarantor to performance in event of nonperformance by the principal obligor.” BLACK’S LAW DICTIONARY 705 (6th ed. 1991).
a loan might be secured by a deed of trust on the restaurant property and by a chattel mortgage on the restaurant equipment. This situation can be governed by the California Commercial Code, California real property secured transaction law or both. Guarantors' rights under the California Commercial Code are different than those under California real property secured transaction law. What are your uncle's rights in each of these situations? Should he consent to waiver of his rights at the time of the loan? Would this waiver be valid?

The law in these areas is problematic for the lender and guarantor alike. The guarantor is subject to abuse by an unscrupulous lender. Waivers of guarantors' rights are often not "knowing waivers" and have been compared to adhesion contracts due to the inequality of the bargaining power of the parties. In addition, the lender is often uncertain as to whether and how to proceed against the guarantor upon the default of the principal borrower.

2. In spite of the dangers of suretyship, this three party legal relationship has been around since the dawn of recorded history. The earliest known contract of suretyship is recorded on a cuneiform tablet taken from the library of Sargon I, King of Sumer and Accad in about 2750 B.C. BARKLEY CLARK, THE LAW OF SECURED TRANSACTIONS UNDER THE UNIFORM COMMERCIAL CODE (1988).

3. CAL. CIV. CODE § 2810 (West 1991). Civil Code § 2810 provides:

A surety is liable, notwithstanding any mere personal disability of the principal, though the disability be such as to make the contract void against the principal; but he is not liable if for any other reason there is no liability upon the part of the principal at the time of the execution of the contract, or the liability of the principal thereafter ceases, unless the surety has assumed liability with knowledge of the existence of the defense.

Id. (emphasis added).

Waiver provisions in guarantee "agreements" commonly list by number and in fine print, the Civil Code sections that are being waived. No substantive explanation is set forth regarding either the borrower's defenses or the fact that the "agreement" may result in non-reimbursable liability for the guarantor in the event that the borrower invokes one or more of the defenses to limit or extinguish liability on his part. Where a friend or relative agrees gratuitously to guarantee a promissory note secured by real property, one may presume almost axiomatically that the guarantor, at the time he assumes liability, has no awareness of the nature of the principal's possible anti-deficiency defenses. Barbara B. Rintala, California's Anti-Deficiency Legislation and Suretyship Law: The Transversion of Protective Statutory Schemes, 17 U.C.L.A. L. REV. 245, 323 (1969).

4. Rintala, supra note 3, at 324-27. An adhesion contract is usually a standardized form offered to the [borrower] on a "take it or leave it' basis without affording [the borrower and guarantor a] realistic opportunity to bargain and under such conditions that [the borrower] cannot obtain the desired [loan] except by acquiescing in form contract." BLACK'S LAW DICTIONARY 40 (6th ed. 1991).
This comment will review the law in this area as it now stands in order to highlight the existing confusion and inequity and will suggest legislation that clarifies the rights of lenders and guarantors.

II. BACKGROUND

A. Guarantors' Rights Under California's Code of Civil Procedure

1. The Anti-Deficiency Legislation

In order to fully understand the rights and liabilities of secured transaction guarantors, some basic familiarity with the California anti-deficiency statutes is necessary.5 The following section provides a brief synopsis of these statutes, highlighting the issues considered by this comment.

a. The Code of Civil Procedure Section 726 “One-Action” Rule

Code of Civil Procedure section 726 provides, in part, that “[t]here can be but one form of action for the recovery of any debt or the enforcement of any right secured by mortgage upon real property.” The general effect of the provision is to make foreclosure the sole remedy available to an unpaid real property secured lender.7 The secured lender is thus denied the possibility of an action solely on the note.8 The result of this is that section 726 is a “security first” rule as well as a “one-action” rule. A lender must seek relief from the sale of the security before seeking a personal judgment against the

5. Often referred to as a group, the “anti-deficiency statutes” were enacted in the depression era to protect real property purchasers who borrow money, securing the debt by either a real property mortgage or a deed of trust. See Roger Bernhardt, California Mortgage and Deed of Trust Practice § 4.1 (2d ed. 1990). See generally John R. Hetland, California Real Estate Secured Transactions (1970). The sections most often referred to are Code of Civil Procedure §§ 726, 580(a), (b), (d).


7. In an effort to provide consistency for the purpose of clear analysis the term “lender” will be used herein, except where a distinction is necessary, to mean lender, creditor, or trustor. For the same reason “borrower” will be used in the same way to mean borrower, debtor, or trustee. Unless otherwise stated, assume that the beneficiary of all deeds of trust described herein is the lender.

8. Bernhardt, supra note 5, at § 4.3.
defaulting borrower. The espoused purpose of the statute is to prevent the lender from bringing multiple actions against the defaulting borrower.

Section 726 can be invoked by the defaulting borrower in either of two possible ways. At the outset of a suit by the lender on the note, and prior to foreclosure, the borrower may invoke the "affirmative defense" aspect of the statute in that the borrower may force the lender to pursue the security by foreclosure sale. If the lender is able to get a judgment on the note, i.e., the borrower fails to raise the "affirmative defense" aspect of section 726, and then later attempts to enforce the security instrument, the "sanction effect" may be invoked by the borrower. The result is that once judgment is obtained on the note, the lender loses any priority that the security instrument might have provided. As will become apparent, the "one-action" rule is a necessary component of California's borrower protection scheme. If the lender is not forced to pursue the remedy of foreclosure upon the default of the borrower, the lender may avoid the statutory protection for borrowers.

California accords borrower protection significant weight. Both the legislature and the courts have held that section 726 is not waivable by the borrower at the inception of the loan. However, the courts have often upheld waivers subsequent to the execution of the mortgage. The logic here is that the duress that might compel the waiver subsides once the loan is granted by the lender.

The "one action" rule of Code of Civil Procedure section 726 is personal to the borrower and is not available to parties

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10. Felton v. West, 36 P. 676, 678 (Cal. 1894).
12. Id.
13. Id.
14. BERNHARDT, supra note 5, at § 4.4.
17. BERNHARDT, supra note 5, at § 4.49. See Palm v. Schilling, 244 Cal. Rptr. 600 (Ct. App. 1988).
who are secondarily liable, such as guarantors. However, the reasoning by which guarantors have been denied section 726 protection stems from the now abolished distinction between guarantors and sureties. Today the basis for this reasoning may be no longer tenable.

b. Code of Civil Procedure Section 580(a) "Fair Value" Limitations

Code of Civil Procedure section 580(a) states in part:

Whenever a money judgment is sought for the balance due upon an obligation for the payment of which a deed of trust or mortgage with power of sale upon real property or any interest therein was given as security ... the court may render judgment for not more than the amount by which the entire amount of the indebtedness due at the time of the sale exceeded the fair market value of the real property ... at the time of sale ... provided, however, that in no event shall the amount of said judgment ... exceed the difference between the amount for which the property was sold and the entire amount of the indebtedness secured by said deed of trust or mortgage.

This section limits the amount of any obtainable deficiency judgment to either the difference between the unpaid debt and the fair value of the security, or the difference be-

21. Code of Civil Procedure § 726 also contains analogous "fair value" provisions, providing that deficiency judgments are limited to:
   the amount by which the amount of the indebtedness ... exceeds the fair value of the property ... as of the date of sale [provided, however, that in] no event shall the amount of the judgment ... exceed the difference between the amount for which the property was sold and the entire amount of the indebtedness ...
   CAL. CIV. PROC. CODE § 726(b) (West 1991). See BERNHARDT and HETLAND, supra note 5. The provisions of § 726(b) apply to judicial foreclosure proceedings while the language of 580(a) applies to non-judicial foreclosure proceedings.
22. CAL. CIV. PROC. CODE § 580(a) (West 1991). See BERNHARDT and HETLAND, supra note 5.
between the debt and the sale price of the security, whichever is less. For example, if the foreclosing secured lender is owed $800,000 at the time of the sale and the highest bid at the sale is $700,000, the lender will be able to obtain a deficiency judgment for $100,000 if the court finds that the fair value of the property is $700,000 or less. If the court determines that the fair value at the time of the sale was $725,000, the lender is restricted to a $75,000 deficiency judgment. This section is extremely important in determining a guarantor’s liability.

2. The Protection of “Purchase Money” Debtors and Code of Civil Procedure Section 580(b)

Code of Civil Procedure section 580(b) provides:

No deficiency judgment shall lie in any event after any sale of real property for failure of the purchaser to complete his contract for sale, or under a deed of trust, or mortgage, given to the vendor to secure payment of the balance of the purchase price of real property, or under a deed of trust, or mortgage, on a dwelling for not more than four families given to a lender to secure repayment of a loan which was in fact used to pay for all or part of the purchase price of such dwelling occupied, entirely or in part, by the purchaser.

Where both a chattel mortgage and a deed of trust or mortgage have been given to secure payment of the balance of the combined purchase price of both real and personal property, no deficiency judgment shall lie at any time under any one thereof if no deficiency judgment would lie under the deed of trust or mortgage in real property.

Section 580(b), in its most basic sense, prohibits creditors from obtaining any deficiency judgment following a foreclosure sale, whether judicial or non-judicial, of real property that secures a purchase money loan. The 580(b) definition of purchase money is money loaned by the seller to the purchaser or, if loaned by an entity other than the seller, money used all or

24. The importance of this section in determining a guarantor’s liability is discussed infra § II.A.2.
in part to pay for any dwelling of four units or less occupied entirely or in part by the purchaser.\footnote{BERNHARDT, supra note 5, at \S 4.23. A full examination of the scope of \S 580(b) purchase money protection is beyond the reach of this comment. It suffices to say that the California Supreme Court has held that the coverage of \S 580(b) is limited to "standard" purchase money transactions and certain variations of these models which do not offend the purposes of the statute. Spangler v. Memel, 498 P.2d 1055 (Cal. 1972); Roseleaf Corp. v. Chierighino, 378 P.2d 97 (Cal. 1963). The purposes of \S 580(b) as announced in the Roseleaf case are (1) to prevent overvaluation of the land used for security by the seller and (2) to avoid aggravation of market decline that would potentially result if defaulting debtors were burdened with large deficiency judgments. 378 P.2d at 101.}

The character of the note determines whether the loan is classified as purchase money.\footnote{Brown v. Jensen, 259 P.2d 425, 427 (Cal. 1953).} The note is characterized at the inception of the loan.\footnote{Id.} The future consequences of section 580(b) are determined according to the factual situation at the time the loan is made rather than what occurs once the loan is in default.\footnote{Paramount Sav. & Loan Ass'n v. Barber, 69 Cal. Rptr. 390, 392 (Ct. App. 1968).} The effects of 580(b) contrast with the other anti-deficiency rules in that they are fixed at the outset of the borrower-lender relationship.

Take, for example, a lender holding a deed of trust securing a $500,000 promissory note given to a borrower for the purpose of purchasing a family residence. A few years after the loan is funded, the borrower is unable to continue to make payments on the loan and defaults. The lender forecloses. At the time the lender forecloses, $350,000 of the principal balance of the loan is still outstanding. The foreclosure sale of the property only brings a price of $200,000. Because of section 580(b), the lender may not pursue the borrower under the note for the $150,000 "deficiency" resulting from the sale.

d. Prohibition of Deficiency Judgments Following Non-Judicial Foreclosure and Code of Civil Procedure Section 580(d)

Code of Civil Procedure section 580(d) provides in part:

No judgment shall be rendered for any deficiency upon a note secured by a deed of trust or mortgage upon real property hereafter executed in any case in which the real property has been sold by the mortgagee or trustee under the power of sale contained in such mortgage or deed of
trust.  

Section 580(d), the final piece of California's depression-inspired borrower protection legislation, completely bars any deficiency judgment where the lender forecloses non-judicially, that is, pursuant to the power of sale clause contained in most standard deeds of trust.  

The judicially announced purpose of this statute is "to put judicial enforcement on a parity with private enforcement," the so-called "parity of remedies" argument.  

30. CAL. CIV. PROC. CODE § 580(d) (West 1991). See BERNHARDT and HETLAND, supra note 5.  
31. BERNHARDT, supra note 5, at § 4.14. Code of Civil Procedure § 580(d) was enacted in 1939 and became effective in 1941. Id.  
32. A common power of sale clause may appear as follows:  
It is mutually agreed that . . . upon default by Trustor in payment of any indebtedness secured hereby or in performance of any agreement hereunder, Beneficiary may declare all sums secured hereby shall immediately become due and payable at the option of the Beneficiary. In the event of default, Beneficiary may employ counsel to enforce payment of the obligations secured hereby, and shall execute or cause the Trustee to execute a written notice of such default and of his election to cause to be sold the herein described property to satisfy the obligations hereof, and shall cause such notice to be recorded in the office of the Recorder of each county wherein said real property or some part thereof is situated.  
Prior to publication of the notice of sale, Beneficiary shall deliver to Trustee this Deed of Trust and the Note or other evidence of indebtedness which is secured hereby, together with a written request for the trustee to proceed with a sale of the property described herein, pursuant to the provisions of law and this Deed of Trust.  
Notice of sale having been given as then required by law, and not less than the time then required by law having elapsed after recordation of such notice of default, Trustee, without demand on Trustor, shall sell said property at the time and the place fixed by it in said notice of sale, either as a whole or in separate parcels and in such order as it may determine, at public auction to the highest bidder for cash in lawful money of the United States, payable at time of sale. Trustee may postpone sale of all or any portion of said property by public announcement at such time and place of sale, and from time to time thereafter may postpone such sale by public announcement at the time and place fixed by the preceding postponement. Trustee shall deliver to the purchaser its deed conveying the property so sold, but without any covenant or warranty, express or implied. The recitals in such deed of any matters or facts shall be conclusive proof of the truthfulness thereof. Any person, including Trustor, Trustee, or Beneficiary, may purchase at such sale.  
BERNHARDT, supra note 5, app. at 462-64.  
34. The statutory right to post-sale redemption, set out in Civil Code §§
This aim is accomplished by giving the borrower the right to redeem after a non-judicial sale. Justice Traynor explained the California Supreme Court's reasoning this way:

By choosing... to bar a deficiency judgment after private sale, the Legislature achieved its purpose without denying the creditor his election of remedies. If the creditor wishes a deficiency judgment, his sale is subject to statutory redemption rights. If he wishes a sale resulting in non-redeemable title, he must forego the right to a deficiency judgment. In either case the debtor is protected.

As is explained in the following section, this language is also used for the benefit of guarantors in the situation where the lender proceeds against the borrower non-judicially.

Therefore, in a situation where a lender has made a loan to a borrower for the purchase of a small office complex to be leased to third parties, and the borrower goes into default, the lender has two options under section 580(d). If the lender wants to maintain its right to pursue the borrower for any deficiency existing after the foreclosure sale of the office complex, the lender must follow the judicial sale procedure. In this instance, because of the nature of the property, the borrower does not benefit from the protection of section 580(b). However, because of section 580(d), if the lender wishes to sell property through the more expeditious non-judicial sale procedure, it waives its right to pursue the borrower for any resulting deficiency.

2. Guarantors and The Anti-Deficiency Legislation

Generally, guarantors do not share the protection given to borrowers by the anti-deficiency statutes. These decisions

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2903-2905, allows a period during which the former borrower-owner can repurchase the property sold at the foreclosure sale from the foreclosure sale buyer at the price paid by the buyer. Thus, if the property is sold for less than its fair value, it may be repurchased for this same lower amount. This rule is intended to encourage more competitive bidding and discourage lenders from purchasing the security at prices far below market value.

35. 378 P.2d at 101-02.

36. Id.

are acceptably logical in the limited sense that the provisions of the anti-deficiency legislation do not govern the rights and liability of a mortgagor-borrower's guarantor. As discussed below in Section III, the guarantor's liability in this situation is correctly governed by the Civil Code sections applicable to guarantors and sureties, not the anti-deficiency legislation which correctly governs the relationship between the lender and the primary borrower. In choosing not to implement the Civil Code sections enacted to protect guarantors from abusive lenders, the courts have blurred the issue of guarantors' liability where the principal borrower has defaulted and is protected by the anti-deficiency statutes.

The anti-deficiency rules are ill-equipped to deal with guarantors in an equitable manner. As interpreted by the courts, this set of statutes makes it more efficient for the lender to pursue the guarantor in some instances where a borrower has defaulted. An example would be a situation where a borrower has given a lender a note, a guarantee agreement signed by a third party, and a deed of trust securing the note on a piece of property with a structure erected upon it. The purchase of the property is the purpose of the loan, with the borrower becoming the owner. During the repayment period, the structure on the property becomes dilapidated due to the neglect of the borrower. The borrower goes into default. If the amount the lender thinks it can obtain at the foreclosure sale is less than the amount of the resulting deficiency, and it is clear that the borrower is nearing insolvency, as is likely considering the pending default, it would be more efficient for the borrower to sue the guarantor directly on the guarantee, bypassing the property under the deed of trust.

The California Supreme Court has ruled that notwithstanding the "security first" requirement of Code of Civil Procedure section 726 the lender may proceed against the guarantor prior to any attempt to satisfy the debt through the sale

App. 1964).

38. Rintala, supra note 3, at 263.
39. For a commendable application of the anti-deficiency legislation to protect guarantors see Michelle M. Erlach, Comment, Guarantors' Defenses to a Deficiency: A Legislative Solution, 31 SANTA CLARA L. REV. 641 (1991).
40. The applicable Civil Code sections are set out infra in § II.B.
of the security.\textsuperscript{41} This rule was grounded in the characterization of the guarantee agreement as “independent” from the agreement between the borrower and lender. In cases predating the 1939 abolition of the separation between sureties and guarantors, this distinction was used to further bolster the rule.\textsuperscript{42}

The fair value provisions of Code of Civil Procedure section 580(a) have also been held to be not applicable to guarantors.\textsuperscript{43} Coupled with the fact that borrowers regularly require guarantors to waive their Civil Code rights\textsuperscript{44} the result is that there is little incentive for the lender to sell the property at the highest price possible.\textsuperscript{45} The greater the gap between the selling price of the security and the balance owing on the note, the greater the potential judgment against the guarantor.\textsuperscript{46}

Section 580(b) can also act to the detriment of the secured borrower's guarantor. The ultimate liability of the guarantor is often dependent on the character of the principal's note. Where the principal's note and deed of trust are purchase money, the borrower is never liable for any deficiency judgment.\textsuperscript{47} A judgment identical in amount and substance to the potential deficiency judgment against the borrower, obtained by the lender which is had instead against a guarantor, is not viewed as a deficiency.\textsuperscript{48} Thus, where the lender seeks and obtains a judgment from the guarantor and the guarantor seeks indemnity from a principal borrower holding a purchase money note, 580(b) acts as an affirmative defense to the guarantor's action.\textsuperscript{49} In this situation the guarantor is thus

\begin{enumerate}
\item Loeb v. Christie, 57 P.2d 1303, 1304 (Cal. 1936).
\item Id. Prior to the abolition of the distinction between sureties and guarantors, Civil Code protection was available only to guarantors. This distinction and its demise under Civil Code § 2787 is discussed infra § II.B.
\item See infra § II.B.
\item Cynthia A. Mertens, California's Foreclosure Statutes: Some Proposals For Reform, 26 SANTA CLARA L. REV. 533, 567 (1986).
\item A discussion of the mechanics producing this result is included infra § IV.B.
\item CAL. CIV. PROC. CODE § 580(b) (West 1991). See, e.g., Mertens, supra note 45, at 566-67.
\item Gottschalk v. Draper Cos., 100 Cal. Rptr. 434, 436 (Ct. App. 1972).
\end{enumerate}
solely liable for the balance due on the principal’s note at default due to the purchase money character of the debtor’s note. The California Supreme Court has yet to rule on this issue of whether a guarantor is protected by Code of Civil Procedure section 580(b), preventing deficiency judgments following foreclosure.

There is, however, one narrow factual situation where the anti-deficiency legislation actually benefits the guarantor. This is the situation the Second District Court of Appeal came across in *Union Bank v. Gradsky.* In this case the note was not of purchase money character. The bank non-judicially foreclosed under the power of sale provision in the deed of trust. Because of this non-judicial sale the borrower was vested with immunity from a deficiency judgment by Code of Civil Procedure section 580(d). This immunity was found to be good against both the lender and the guarantor. The guarantor was therefore prevented from obtaining any indemnification from the principal borrower due to the fact that the lender chose to conduct a trustee’s sale rather than judicial foreclosure. The *Gradsky* court held that the lender was estopped from pursuing a deficiency judgment from the guarantor because of its choice to “pursue a remedy which destroys both the security and the possibility of the surety’s reimbursement from the principal debtor.” The court felt that the lender rather than the guarantor should bear the burden of its choice to pursue the non-judicial sale.

The problem with applying or not applying the strictures of the anti-deficiency rules to guarantors is that the focus of these rules is on the creditor’s interest in the guarantor’s obligation rather than the secondary nature of the guarantor’s liability. The rules governing the rights and liabilities of creditors and debtors with respect to property collateral are not the rules governing the rights and liabilities of those two parties

50. 71 Cal. Rptr. 64 (Ct. App. 1968).
51. Id. at 65.
52. Id. at 66.
53. Id. at 69.
54. Id.
55. A trustee’s sale is a form of non-judicial foreclosure.
56. 71 Cal. Rptr. at 69.
57. Id.
58. Id.
with respect to a secondarily liable guarantor.\textsuperscript{59} The California Civil Code provides for this relationship in a separate title.\textsuperscript{60}

B. Guarantors’ Rights Under the California Civil Code

A guarantor of a secured transaction involving real property in California has many protections available prior to signing the guarantee agreement. In 1939 section 2787 of the California Civil Code was amended to abolish the distinction between guarantors and sureties.\textsuperscript{61} Prior to 1939 California’s Civil Code distinguished guarantors as a subset of sureties.\textsuperscript{62} A surety was one who becomes a party, secondarily liable, under the terms of the primary agreement between the borrower and the lender;\textsuperscript{63} a guarantor was secondarily liable to the lender due to an independent agreement with the lender.\textsuperscript{64} Before this distinction was taken off the books, Civil Code protection was to a large part limited to sureties. Guarantors now have at a minimum all the rights formerly available to both guarantors and sureties under California’s Civil Code and Code of Civil Procedure.\textsuperscript{65}

The rights accorded guarantors define their status and distinguish the secondarily liable guarantor from a primarily obligated party.\textsuperscript{66} These rights include, but are not limited to, sections 2809, 2810, 2819, and 2845-50 of the Civil Code. Together they provide that a guarantor’s liability is limited to that of his\textsuperscript{67} principal.\textsuperscript{68} The guarantor is allowed to control

\textsuperscript{59} Rintala, \textit{supra} note 3, at 271-72.
\textsuperscript{60} Rintala, \textit{supra} note 3, at 271-72.
\textsuperscript{61} \textit{CAL. CIV. CODE} § 2787 (West 1991).
\textsuperscript{63} \textit{See} \textit{Everts}, 132 P.2d at 481-82.
\textsuperscript{64} \textit{Id.}
\textsuperscript{65} \textit{CAL. CIV. CODE} § 2787 (West 1991).
\textsuperscript{66} Rintala, \textit{supra} note 3, at 329.
\textsuperscript{67} The pronouns “he,” “his,” and “him,” as used at various points in this comment, are not intended to convey the masculine gender alone; this usage is employed in a generic sense so as to avoid awkward grammatical situations which would likely occur due to the limitations of the English language. W. PAGE KEETON ET AL., \textit{PROSSER AND KEETON ON THE LAW OF TORTS} at xvii (5th ed. 1984).
\textsuperscript{68} \textit{CAL. CIV. CODE} §§ 2809-2810 (West 1991).
whether the conditions or degree of the guarantor’s liability

69 The guarantor can require that the primarily liable borrower be pursued prior to any action against the guarantor.70 Finally, the guarantor has the right to obtain reimbursement from the primary borrower should the guarantor satisfy the obligation where the primary borrower’s liability has not been fully pursued by the lender.71

Arguably, the most important of these rights is Civil Code section 2845 which allows the guarantor to force the lender to pursue the principal borrower’s security prior to any action against the guarantor.72 Section 2845 is written to operate for guarantors in a manner similar to the way California Code of Civil Procedure section 726 operates for the benefit of borrowers. Section 2845 has an “affirmative defense” aspect, by which the guarantor can force the lender to go after the primary security first in order to lighten the burden of the guarantor.73 It also provides for a “sanction effect” which exonerates the guarantor to the extent that he is prejudiced by the lender’s decision to proceed against the guarantor prior to pursuing the primary borrower.74 Early cases held that the lender is not required to go after the security first, but these cases may no longer be authoritative due to the abolition of the distinction between guarantors and sureties.75

However, the applicability of section 2845 varies from Code of Civil Procedure section 726 in a material way. The protections of section 726 are waivable by the borrower subse-

69. Id. § 2819.
70. Id. §§ 2845-2846, 2849-2850.
71. Id. §§ 2847-2849.
73. “A surety may require his creditor . . . to proceed against the principal, or to pursue any other remedy in his power which the surety cannot himself pursue . . .” CAL. CIV. CODE § 2845 (West 1991).
74. “[I]f in such case the creditor neglects to do so, [to pursue remedies not available to the surety] the surety is exonerated to the extent to which he is thereby prejudiced.” Id.
75. Everts v. Mattson, 132 P.2d 476, 481 (Cal. 1943) (lender forecloses, sues guarantor for the deficiency); Security-First Nat’l Bank v. Chapman, 106 P.2d 431, 432 (Cal. 1940) (lender elected to pursue recovery of the deficiency from the guarantor, waiving the possibility of recovering from the borrower); Bank of America v. Hunter, 67 P.2d 99, 101 (Cal. 1937) (guarantor agreed to remain fully bound until the underlying debt was completely paid).
quent to the execution of the deed of trust. The courts have allowed guarantors to waive section 2845 even though Code of Civil Procedure section 726 is not waivable at the time the loan is made; on the other hand, guarantors may waive 2845 prior the time the loan is made.

Prior to signing the guarantee agreement, the guarantor also has Civil Code sections 2809 and 2810 at his disposal. Section 2809 protects the guarantor by limiting the guarantor’s potential obligation to that of the principal obligation. Civil Code section 2810 provides that the guarantor is not liable if there is no liability on the part of the borrower. Although it is possible to argue that this would prevent a deficiency judgment against the guarantor where the borrower is protected by the anti-deficiency statutes, the courts have found this not to be the case. This rejection of this argument is based on the principle that Code of Civil Procedure section 580(d) does not eliminate the borrower’s liability, but only prevents recovery against him.

77. Wiener v. Van Winkle, 78 Cal. Rptr. 761, 769 (Ct. App. 1969) (guarantor waived Civil Code §§ 2845 and 2849 through language in the guarantee agreement); Union Bank v. Gradsky, 71 Cal. Rptr. 64, 67 n.3 (Ct. App. 1968) (guarantor waived Civil Code §§ 2810 and 2819 by the guarantee agreement); Engelman v. Bookasta, 71 Cal. Rptr. 120, 121-22 (Ct. App. 1968) (attachment of guarantor’s property allowed due to his waiver of Civil Code rights); American Guar. Corp. v. Stoody, 41 Cal. Rptr. 64, 67-72 (Ct. App. 1964) (as guarantor waived his Civil Code rights, the court upheld attachment of the guarantor’s property notwithstanding the secured status of the note).
80. Id. § 2809.
81. Id.
82. “Technically, a deficiency judgment is a judgment against the [secured borrower] for the difference between the unpaid balance of the secured debt (plus expenses) and the amount produced by the [foreclosure] sale.” BERNHARDT, supra note 5, at § 4.13.
83. The effects of the anti-deficiency statutes on guarantor liability are discussed supra § II.A.2. For the moment it suffices to say that there are factual situations where the lender may be barred by the California Code of Civil Procedure from proceeding against the borrower for the amount owing on the debt exceeding the sum brought by the sale of the security, limited by the amount of the debt (i.e., a deficiency judgment).
85. See supra notes 30-32 and accompanying text.
86. See supra notes 30-32 and accompanying text.
Although it would seem that the legal boundaries of a guarantor’s rights and liabilities are clearly marked, this is patently not the case. California’s courts, in a series of cursory holdings, have held that the guarantor’s basic Civil Code rights are waivable.\(^8\) No articulation of the rationale or policy for allowing guarantors to do so has been set forth by the courts. Most preprinted guaranty agreements contain obscure waiver provisions.\(^8\) The waivers are usually required by a lender holding a superior financial posture where the guarantor is in no position to negotiate. Whether waivers of this sort are consistent with public policy is questionable as these agreements seem to be in the form of adhesion contracts. There may be great pressure on the guarantor to sign the guarantee from the borrower. Further it is reasonable to assume that many guarantors do not understand the nature and extent of the liability they are incurring. The problems surrounding waivers of this type are discussed below.

C. Guarantor Protection Under The California Commercial Code

1. Commercial Code Guarantors’ Liability

Guarantors of personal property secured transactions within the scope of the California Commercial Code who do not sign an independent guarantee agreement are termed “accommodation parties.”\(^9\) “An accommodation party is one who signs the instrument in any capacity for the purpose of lending his name to another party to it.”\(^9\) The accommodation party is thus a party who, by signing the instrument, becomes liable if the borrower defaults on the instrument.

The California Commercial Code provides that the parties may elect in what capacity the guarantor shall be liable. At the

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\(^8\) American Guar. Corp., 41 Cal. Rptr. at 71-72.

\(^9\) CAL. COM. CODE § 3415(1) (West 1991). This section was adopted from the official text of the Uniform Commercial Code without change. Id. § 3415 cmt. 9. “[A]n accommodation party is always a surety (which includes a guarantor), and it is his only distinguishing feature. He differs from other sureties only in that his liability is on the instrument and he is a surety for another party to it.” U.C.C. § 3-415 cmt. 1 (1962).

time the accommodation agreement is signed the parties elect whether the lender must go to the collateral first. This is determined by the capacity in which the guarantor signs the agreement. Unlike guarantors of real property secured transactions, guarantors of personal property secured transactions determine with the other parties whether the lender must go to the security first. This seems reasonable in that parties to transactions governed by the Commercial Code are more likely to be on more equal financial footing.

If the guarantor qualifies his signature with the words "payment guaranteed" or some equivalent and the instrument is not paid in full when due, the guarantor is liable for the full amount "without resort by the holder to any other party." The lender would, under the contract, be able to proceed directly against the guarantor. Thus, the liability of the guarantor of payment is indistinguishable from that of a maker. If a person, signing in the capacity of a guarantor, does not indicate the capacity in which he intends to sign, he is deemed to have guaranteed payment.

However, if the guarantor qualifies his signature with the words "collection guaranteed" or some equivalent and the instrument is not paid in full when due, the guarantor will be liable to the lender "only after the holder has reduced his claim against the maker or acceptor to judgment and execution has been returned unsatisfied, or after the maker or acceptor has become insolvent or it is otherwise apparent that it is useless to proceed against him." Thus where the guarantor signs choosing to guarantee collection of the debt only, the lender must exhaust his remedies against the principal borrower before attempting to obtain any satisfaction of the debt from the guarantor. A guarantor of collection, therefore, has substantially reduced liability relative to a guarantor of payment.

91. Id. § 3416.
92. In this situation, "holder" is equivalent to "lender."
94. U.C.C. § 3-416 cmt. 3 (1972). "Maker" is equivalent to "borrower."
95. CAL. COM. CODE § 3416(3) (West 1991). "Words of guaranty which do not otherwise specify guarantee payment." Id.
96. Id. § 3416(2).
2. Defenses Available to Commercial Code Guarantors

The guarantor has all the usual contract defenses of any party to a negotiable instrument. 97 The guarantor also gets the benefit of any defenses available to the principal borrower. 98 Additionally, the guarantor has the benefit of the suretyship defenses listed in section 3-606. These defenses discharge the guarantor from liability where the lender discharges the principal borrower, extends the time for payment, or impairs the collateral. 99 The underlying principle of the suretyship defenses is based on the notion that any action by the lender which increases the liability of the surety alters the surety's agreement and thereby should release him. 100 The Commercial Code does not require that the increase in the surety's burden cause him harm. The availability of the defenses in section 3-606 does not depend upon prejudice.

3. Commercial Code Guarantors' Affirmative Rights

Under the Commercial Code the guarantor retains the rights of reimbursement and subrogation. 101 The borrower is bound to reimburse the guarantor if the guarantor is called upon to pay the entire principal obligation or any part of it. 102 This recovery is effected on a suit by the guarantor on the instrument. 103

The guarantor can also subrogate to the position of the lender and hold the principal borrower liable. 104 This is similar to the right of reimbursement. 105 However, there are situ-

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100. Alderman, supra note 97, at 623. The California Civil Code also provides for this problem but in a slightly different manner: "The obligation of a surety must be neither larger in amount nor in other respects more burdensome than that of the principal." Cal. Civ. Code § 2809 (West 1991).
101. Cal. Com. Code § 3415(5) (West 1991); Alderman, supra note 97, at 645. Where there are co-sureties, they may sue for contribution between themselves. Alderman, supra note 97, at 646. The liability of co-sureties as between themselves is beyond the scope of this comment.
103. Alderman, supra note 97, at 645.
104. Alderman, supra note 97, at 645.
105. See Alderman, supra note 97, at 645. A guarantor seeking reimbursement
ations where subrogation has procedural or other advantages. In these situations the guarantor may opt for subrogation.

D. The Unified Sale Provision—California Commercial Code Section 9501(4)

1. Default by a Mixed Collateral Borrower

California Commercial Code section 9501(4) sets out the rights and remedies of parties to mixed collateral transactions, that is those involving a debt or obligation secured by both personal property or fixtures and real property. Section 9501(4) sets out the procedure lenders are to follow when a mixed collateral borrower defaults. In a general sense it allows the lender three options. First, the lender may proceed independently under both real and personal property laws by foreclosing on all the real property following real property rules and on all the personal property following personal property rules. Second, the lender may conduct a unified sale of the real and personal property under real property rules. Finally, the lender may proceed by first selling some of the personal property under personal property rules and some of the real property under real property rules. Then, at a later time, the lender may sell the balance of the personal property and the real property under real property rules.

Section 9501(4) goes on to delineate which of the real property anti-deficiency rules should apply and when. The effects of the California Code of Civil Procedure section 726 “one-action” rule are expressly nullified in respect to any personal property. Therefore, a secured lender who forecloses on personalty and thereafter obtains a deficiency judgment is attempting to recover from the borrower only the amount paid to the lender. When subrogated to the rights of the lender by satisfying the borrower’s debt to the lender, the guarantor assumes the position of the lender as to the principal obligor and may enforce the lender’s rights against the borrower to the extent possible. Alderman, supra note 97, at 645-46.


108. Id. § 9501(4)(a)(ii).

109. Id. § 9501(4)(a)(iii).

110. Id. § 9501(4)(b). See also Di Geronimo, supra note 106, at 431-32.
against the borrower will be deemed to have waived any real property collateral not included in the judicial action.\footnote{Walker v. Community Bank, 518 P.2d 329, 335 (Cal. 1974). Although the definition of "judicial action" for Code of Civil Procedure § 726 is beyond the scope of this comment, for the purposes of Commercial Code § 9501, a judicial action has been had "if and only if a monetary judgment on the debt is sought against the debtor." \text{CAL. COM. CODE} § 9501(4)(c)(ii) (West 1991).}

However, the effects of California Code of Civil Procedure sections 580(b)\footnote{Id. § 9501(4)(c)(i).} and 580(d)\footnote{Id. § 9501(4)(c)(iv).} are applicable to the personalty. The result of applying section 580(b) is that lenders holding notes secured by mixed collateral which are of purchase money character cannot obtain any deficiency judgment against the primary borrower. Borrowers are limited to the amount obtainable upon foreclosure sale of the security. The application of section 580(d) prevents any deficiency judgment following a non-judicial sale of either the personal property or the real property or both if a unified sale is elected.

2. Rights of Guarantors of Mixed-Collateral Transactions

The rights and the ability to waive the rights granted under the Civil Code and the Code of Civil Procedure for guarantors of real property transactions are substantially different than those for guarantors of personal property secured transactions. Generally, guarantors of real property secured transactions are required to waive any and all statutory protection at the time of the signing of the guarantee agreement.\footnote{Wiener v. Van Winkle, 78 Cal. Rptr 761, 769 (Ct. App. 1969); Union Bank v. Gradsky, 71 Cal. Rptr. 64, 67 (Ct. App. 1968); Engelman v. Bookasta, 71 Cal. Rptr. 120, 121-22 (Ct. App. 1968); American Guar. Corp. v. Stoody, 41 Cal. Rptr. 69, 71-72 (Ct. App. 1964).} This practice contrasts with California Commercial Code section 9501(3) which provides that certain enumerated rights of the borrower and duties of the lender under the Commercial Code cannot be waived.\footnote{\text{CAL. COM. CODE} § 9501(3) (West 1991). However, "the parties may by agreement determine the standards by which the fulfillment of these rights and duties is to be measured if such standards are not manifestly unreasonable." \textit{Id.}} Therefore, within the personal property secured transaction universe of Division 9 of the California Commercial Code, the legislature has expressed its be-
lie that these rights are of sufficient gravity to justify that their pre-default waiver be prohibited.116

The bar against pre-default waiver of debtor's rights has been extended to guarantors in California. Several cases have held that a guarantor is a borrower within the meaning of Division 9117 of the California Commercial Code.118 The courts tend to protect guarantors to the same degree as debtors. The non-waivable nature of debtor's rights was made de jure applicable to guarantors in the case, American National Bank v. Perma-Tile Roof Company.119

In American National, the bank loaned Perma-Tile $100,000 secured on the roof company's personal property.120 The loan was further secured by guarantees signed by three individuals.121 The guarantees contained clauses waiving the guarantor's remedies.122 Each guarantee agreement also contained the following waiver of all legal rights:

EACH OF US ACKNOWLEDGES THAT ANY LEGAL RIGHTS WE MIGHT OTHERWISE HAVE HAD HAVE BEEN WAIVED UNDER THIS GUARANTY. EACH OF US HAS READ THIS GUARANTY AND WARRANTS THAT SUCH WAIVERS AND THEIR IMPLICATIONS ARE UNDERSTOOD.123

As the guarantor had waived his rights before the borrower defaulted, the court held that the lender had the burden of pleading and proving compliance with Division 9 of the California Commercial Code prior to obtaining a deficiency judgment against the guarantor.124 The plaintiff bank was not able to do so because it had obtained a waiver of the guarantor's

116. Id.
117. Division 9 of the California Commercial Code covers secured transactions, sales of accounts, contract rights and chattel paper. Id. § 9102(1)(a), (b).
119. 246 Cal. Rptr. 381 (Ct. App. 1988).
120. Id. at 382.
121. Id.
122. Id.
123. Id.
124. Id. at 384.
right to notice of default prior to the debtor's default in direct violation of California Commercial Code section 9504(3). Because of the plaintiff bank's failure, among other things, to plead compliance with Division 9, the guarantor was protected, and the bank's request for a deficiency judgment was denied.

The effect of this ruling on guarantors' rights, especially in light of the application of real property rules to mixed collateral secured debtors (and therefore guarantors) under Commercial Code section 9501(4), brings to light the serious confusion as to what exactly the rights of guarantors of secured transactions are. The underlying policy behind this decision of prohibiting the waiver of certain rights of guarantors directly conflicts with that of other cases allowing waiver of important guarantor rights at the inception of the loan. The courts have failed to articulate the justification for this anomaly.

Perhaps more importantly, the confusion provides an opportunity to re-examine whether guarantors should be able, in any case, to waive their rights prior to default.

III. IDENTIFICATION OF THE LEGAL PROBLEM

The problems which currently exist in this area stem from the secondary results of what appears, at first blush, to be application of sound legal principle. However, upon closer examination, the California courts' application and interpretation of statutes providing for protection of borrowers and guarantors has resulted in a spin-off of confusion and inequity in the area of guarantor law.

The confusion is a product of the conflicting policy underlying different portions of guarantor law. The courts' interpretation of the California Civil Code and the ability of guarantors to waive its provisions results in minimal protection for

125. *Id.* Section 9504(3) states in relevant part, "the secured party must give to the debtor, if he or she has not signed after default a statement renouncing or modifying his or her right to notification of sale . . . a notice in writing of the time and place of any public sale or of the time on or after which any private sale or other intended disposition is to be made." *Cal. Com. Code* § 9504(3) (West 1991).

126. 246 Cal. Rptr. at 384.

127. *See supra* text accompanying note 119.

128. *See supra* notes 77-79 and accompanying text.
the secondary nature of a guarantors' liability. At the same time, in an arena where bargaining power is more likely to be equal, the courts' interpretation of the California Commercial Code results in substantially more protection for secondarily liable parties.

The inequity is partially a product of the California courts' unwillingness to closely examine the form and substance of standardized blanket waivers of guarantors' rights. The importance of these rights in defining the secondary nature of a guarantor's liability and the prevalence of their waiver by means of potentially abusive forms prepared by creditors demands closer examination. The validity of these waivers should be questioned due to the inequality of the bargaining power of the parties. In any case, persons wishing to provide secondary assurance for the repayment of debt should not be led into a relationship which, in essence, is equal to that of the primary obligor.

IV. ANALYSIS AND DISCUSSION

A. Should Guarantors Be Allowed to Waive their Statutory Rights?

In the typical lender-borrower-guarantor relationship the lender, by definition, is in a financially superior position. It is undoubtedly contrary to public policy for lenders to use this position in order to negotiate waivers of guarantors' rights. This public policy justification has been used to prohibit the debtor's waiver of the protections of Code of Civil Procedure section 726 prior to the inception of the debt. Civil Code sections 2849-50 operate in an identical manner for guarantors. However, the courts have allowed lenders to require guarantors to waive these Civil Code sections as a prerequisite to the disbursement of funds.

The validity of waivers obtained by a party in a vastly superior negotiation stance is questionable. This seems especially true when the waivers are in the form of broad clauses imbed-

129. "In the area of rights after default our legal system has traditionally looked with suspicion on agreements designed to cut down the [guarantor's] rights and free the secured party of his duties." U.C.C. § 9-501 cmt. 4 (1972).
130. See supra note 5 and text accompanying notes 15-17.
131. This section allows the guarantor to force the lender to pursue the collateral first. CAL. CIV. CODE §§ 2849-2850 (West 1991).
ded in the midst of language unintelligible to the layman, usually written in type too small to read.

The contents of such a waiver clause are exemplified by the language in the guarantee agreement disputed in *Engelman v. Bookasta*,132 which provided, "I hereby waive, for myself and for all other persons . . . (c) any right to require the holder of the within instrument to proceed against the maker or against any other person or to apply any security it may hold, or to proceed to first exhaust any security it may hold or to pursue any other remedy."133 This language was included as the latter third of one of several dense paragraphs of the guarantee agreement. The courts have enforced waivers of this type without providing any detailed analysis of their validity.134 It seems that guarantors are waiving these rights without any real knowledge of what they are giving up. What guarantors are giving up is the very nature of their secondary liability.

The California Civil Code provides a guarantor with rights which allow him to maintain his secondary liability.135 These rights are of very little import if they are summarily waived through the signing of form documents required by the lender. What is a guarantor without these rights? "Considered as one cohesive bundle of protections, these Civil Code provisions ensure the secondary nature of the guarantor's liability and are therefore definitive of, and intrinsic to, one's status as a guarantor as opposed to some other form of obligor."136 The result is that a party signing a standardized guarantee agreement, who is referred to as a guarantor in all of the loan documents and who perceives himself as a secondarily liable party, is really a primary obligor. Clearly public policy asks that waivers of this type be reconsidered.

132. 71 Cal. Rptr. 120 (Ct. App. 1968).
133. Rintala, *supra* note 3, at 331 n.316 (emphasis added).
135. *See infra* § II.B.
B. Allowing Guarantors to Waive their Rights Inhibits Development of the Highest Possible Bid at Foreclosure Sales

One of the policy goals of the statutes which compose the anti-deficiency scheme is to bring about the highest bid possible for collateral sold at foreclosure.\textsuperscript{137} Allowing guarantors to waive their Civil Code rights is directly contrary to this policy. The following hypotheticals illustrate the point.

Assume the typical lender-borrower-guarantor relationship involving a secured debt where the guarantor has signed a waiver agreement similar to the one from \textit{Engelman}.$^{3}$ The borrower defaults. The guarantor, due to his waiver, can no longer force the lender to pursue the borrower in order to lighten the guarantor's burden.$^{139}$ This situation ensures that the lender will receive the full balance due on the note no matter what the sale price of the collateral. As a result, the lender purchases the collateral property for a price below the true value of the property at the foreclosure sale, and then the lender proceeds to sue the guarantor for the remaining balance on the note. This inequity would occur if the guarantor does not have the resources to purchase the security in cash.$^{140}$

As section 580(a) does not apply to guarantors, this "deficiency judgment" is not limited to the difference between the fair value of the security and the outstanding balance due on the note at the time of default in the same way it would be for the borrower.$^{141}$ The lender now receives a double benefit of both the property and a money judgment. The lender's windfall in this situation is equal to the portion of the deficiency judgment which exceeds the fair value of the security. The end result is that the burden to bid the property up to its market value is placed on the secondarily liable guarantor rather than the lender or the borrower.$^{142}$ Note that without the

\textsuperscript{137} This is especially true for Code of Civil Procedure § 580(b).
\textsuperscript{138} \textit{See supra} § IV.A.
\textsuperscript{139} The guarantor would be entitled to force the lender to do so under Civil Code § 2845. \textit{CAL. CIV. CODE} § 2845 (West 1991). \textit{See supra} § II.B.
\textsuperscript{140} \textit{CAL. CIV. CODE} § 2924h(b) (West 1991).
\textsuperscript{141} Mertens, \textit{supra} note 45, at 566-67.
\textsuperscript{142} \textit{Everts v. Matteson}, 132 P.2d 476, 482 (Cal. 1942).
guarantor's waiver the policy of the anti-deficiency scheme would be restored.

In a second hypothetical, assume the same typical lender-borrower-guarantor relationship involving a secured debt where the guarantor has signed the typical waiver agreement. Further assume that the borrower defaults and a foreclosure sale is pending. The lender proceeds to obtain a judgment against the guarantor, who is helpless to force the lender to pursue the security due to the waiver. Assume the judgment is for an amount slightly less than the balance owing. Now assume, with the unsatisfied judgment in hand, the lender proceeds to foreclose on the security. The lender is now assured of a recovery in the amount of the unsatisfied judgment (assuming the guarantor is solvent) and therefore does not need to enter a credit bid at the sale in an amount equalling the outstanding debt balance. Instead the lender can bid significantly lower, possibly purchasing the property to be profitably sold at a later date. Thus, the lender again receives a windfall, this time in an amount equal to the profit made on the subsequent sale of the property less the minimal portion of the outstanding debt balance not recovered from the guarantor and the potentially minimal cost of acquiring the property at the foreclosure sale.

As in the first example, the lender here has obtained the guarantor's waiver due to a superior bargaining position. If the guarantor could have enforced his rights in either of these situations, the lender would have been required to sell the property for its true value and would not have been entitled to any windfall. The language of Code of Civil Procedure section 580(a) can be construed to limit actions of this type, however section 580(a) protection has not been extended to guarantors. Again, the policy of the anti-deficiency scheme would be restored if the guarantor's waiver were not allowed.

C. Guarantors Under the California Commercial Code and Mixed-Collateral Secured Transactions

In instances where a debt is secured by mixed collateral, the conflicts between the policy of the Civil Code and the Commercial Code loom large. This is especially the case where, upon default of the primary obligor, the lender pursues his options under Commercial Code section 9501(4)(a)(i). In
proceeding independently by foreclosing on all the real property following real property rules and on all the personal property following personal property rules, this single transaction will be governed by two conflicting sets of statutes. A guarantor of this transaction is uncertain as to which rules would apply to him. This is especially true in light of the courts’ characterization of guarantors as debtors. There is no direction provided by either statute or judicial decision to guide a guarantor in this situation.

The conflict is exemplified by a situation where a loan to a corporation is secured by a chattel mortgage on the machinery in the corporation’s factory. Because of the shaky financial standing of the corporation, the lender also elicits a guarantee from the very wealthy controlling shareholder. Assume that the guarantor has not waived his Civil Code rights. The guarantor secures the guarantee on his personal residence. Upon the corporation’s default, the lender attempts to foreclose the deed of trust securing the guarantee. Whether the guarantor has the right to force the lender to pursue the chattel mortgage on the machinery is questionable. Civil Code section 2845 would allow the guarantor to do so. However, as a party to a transaction involving personal property under Commercial Code Section 9501(4)(b), he would not be allowed to do so. Whatever the result of this conflict, allowing a waiver in this situation would be tantamount to making the guarantor primarily liable on the corporation’s debt. The policy of the governing statutes provides little guidance as to whether a waiver of this type should be allowed.

An attempt to reconcile the policy of the two potentially conflicting bodies of law only increases the discord. The policy of the Commercial Code dictates that guarantors should not be allowed to consent to pre-default waivers of their rights. Though public policy would lead to the opposite conclusion, the courts have allowed pre-default waivers by guarantors of

143. See supra note 119 and accompanying text.
144. See supra notes 61-68 and accompanying text.
145. Commercial Code § 9501(4)(b) provides in part that “provisions . . . of any law respecting real property and obligations secured by real property, including . . . limitations on the right to proceed as to collateral, do not in any way apply to [proceedings involving personal property].” CAL. COM. CODE § 9501(4)(b).
146. See supra notes 103-08 and accompanying text.
their Civil Code rights. Viewed in a broader sense, these policies seem to have taken the usual and turned it on its head.

The Commercial Code is written to allow maximum flexibility for the parties to construct their own agreements. This makes sense in that the types of transactions governed by the Commercial Code often involve parties standing on equal ground in negotiations. However, where guarantors are concerned, the tendency is to prevent negotiations which result in pre-default guarantor waiver. Conversely the Civil Code, covering a much broader range of transactions involving parties often standing on unequal ground during negotiations, has been interpreted to allow waiver of these important rights. The result is total uncertainty, undesirable for all parties under either set of statutes.

V. PROPOSAL

As the courts have gone far astray down the path of treating guarantors as a mutated form of principal obligor, it is now up to the legislature to effectuate the intent of present surety statutes by ensuring the secondary liability of guarantors. The most simple and direct way to accomplish this end is to prohibit any waiver of guarantors' legal rights prior to the default of the primary obligor. In order to provide a method which most directly meets the desired end, accommodates the interests of clarity, minimizes semantic difficulty, and streamlines administration, the following statutory language is proposed as an addition to Division 7 of the California Civil Code.

§ 2833 WAIVER BY SURETY OR GUARANTOR PRIOR TO DEFAULT OF PRIMARY OBLIGOR INEFFECTIVE.

(a) Any express or implied agreement made or entered into by a guarantor or surety in connection with the making of or renewing of any loan secured by a deed of trust, chattel mortgage, real property mortgage, or other instrument creating a lien on real property, personal property, or both, made at any time prior to the default of the primary obligor and personal service of the notice of default of the primary obligor upon the surety or guarantor,

147. See cases cited supra note 134 and accompanying text.
whereby the surety or guarantor agrees to waive the rights, or privileges conferred on him by Article Seven of this Code, shall be void and have no effect.

(b) If an agreement providing for a waiver of the type described in paragraph (a) of this section is entered into at a time subsequent to the default of the primary obligor and personal service of the notice of default of the primary obligor upon the surety or guarantor, that agreement will be binding so long as the secured debt guaranteed is not reinstated. If said debt is reinstated, the rights of the surety or guarantor are restored and the waiver agreement shall be void and have no effect.

(c) This section shall be effective as to all such agreements described in paragraph (a) herein signed subsequent to [DATE].

Paragraph (a) provides that the guarantor cannot waive his rights prior to the borrower's default. Prior to the signing of a waiver agreement, the guarantor must be personally served with a copy of the notice of default. The intent is to encourage the guarantor to discover what his rights are, allowing him to make an informed decision as to how to proceed.

Paragraph (b) is designed to address the problems that may occur upon reinstatement of the debt. The effect is that the guarantor's rights are restored after the reinstatement of the debt. If the borrower reinstates, the guarantor must re-waive his rights upon a subsequent default of the borrower. Accordingly, in the case of a debt with a long term repayment period, where the debt goes into default at the beginning of repayment, a waiver by the guarantor at that time will not be valid if the debt is reinstated and falls into default several years later. As the guarantor's status may have changed during the intervening years, the waiver must be made again with knowledge of the current situation.

It is important to note that although this statute would alter the way that lenders would have to deal with guarantors of secured transactions, the statutory language does not render the guarantee worthless. The lender is still free to obtain a

148. As providing notice of default to guarantors is a common practice of commercial creditors, no additional burden is placed upon them. Telephone interview with Cynthia Mertens, Professor of Law, Santa Clara University School of Law (January 18, 1991) (expressing opinion only).
waiver from the guarantor following the default of the principal borrower. Assuming that the guarantor signs the post-default waiver, the ensuing lender-guarantor relationship would be one which is indistinguishable from that resulting from a waiver agreement signed at the inception of the loan. The difference would be that guarantors would be apprised of the situation and presumably would be in a position to make informed choices about enforcing their rights.

Furthermore, where a lender feels that it needs more assurance that the loan will be paid, it is free to require the person or entity providing the assurance to join the note as a second primary obligor. Public policy is served when persons providing assurance for the repayment of loans know in what capacity they act. Requiring the lender to make these persons primary obligors only brings their actual relationship into focus. Lenders should not be allowed to continue forming primary obligor relationships under the pretext of empty guarantee agreements.

VI. CONCLUSION

This comment provided a brief outline of the law governing guarantors of secured transactions in California. The competing statutory provisions contain many important protections which insure the secondary nature of a guarantor's liability. The various statutory schemes have been examined, including those portions which deal with guarantors of mixed collateral transactions. The gravity of these rights, as well as the existing conflict among these statutes has been explored in detail.

Currently California's courts allow creditors to obtain blanket waivers of the rights of guarantors. The form and substance of these waivers demonstrates that they are only obtained through the financial superiority of commercial lenders. The result of this type of waiver is that a party expecting to become a secondarily liable guarantor is transformed into a variety of primary obligor. The validity of these waivers has been questioned and tested.

The proposed statutory language would prohibit waivers of this type until after default of the primary obligor. This language would effect the intent of California's suretyship statutes by preserving the secondary nature of a guarantor's liability. At the same time the interests of lenders would be protected by
allowing waivers of guarantors' rights to be obtained after default.

The broader effect of the proposed statute would be to force lenders to deal with potential guarantors fairly. If lenders wish to have additional parties primarily obligated for the repayment of a debt, they should be allowed to do so. When they do wish to do so, equity dictates that the relationships formed should not purport to subject the guarantor to secondary liability when in reality the burden carried by the guarantor is identical to that of the borrower.

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