The Lender's Source

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Bill to Protect Guaranty Agreements Passes Georgia House and Senate Votes

Georgia Senate Bill 37 passed by a wide margin of votes in both the Senate and House, and is now awaiting the Governor's signature. The bill was introduced in response to a 2018 opinion of the Court of Appeals of Georgia, which held (in contrast to many years of precedent) that a written guaranty of debt may be rescinded by an alleged unwritten agreement between the guarantor and lender. This opinion laid a minefield for lenders, who (absent relief such as that proposed in the bill) should expect to face increasing challenges to guaranty enforcement on the basis of supposed verbal representations to guarantors by lender employees.

If approved by the Governor, the bill would amend Georgia statutory law to state that any agreement to rescind, cancel, or release a written guaranty of indebtedness (or certain other types of written contracts) is effective only if it is made in a writing that is signed by both parties to the guaranty, or if the lender admits in court that the agreement was made. Thus, the lender would once again have substantial protection against spurious claims that a guarantor has been verbally released from his guaranty obligations. Signed documentation from the lender would be necessary for an effective release, unless the lender admits in court that it did in fact agree to the undocumented release.

The change provided for by the bill will be a welcome return to the pre-2018 legal landscape that guarded the validity of written agreement. However, it is important to understand that under the bill, as under pre-2018 law, verbal releases can be given and can be binding on the lender. The bill would only provide protection where the lender denies the verbal agreement was actually made.

If called upon to testify in court, the lender's officers and employees must testify truthfully. If the lender cannot truthfully deny that its authorized officer verbally agreed to release the guarantor, a court may give effect to the verbal release agreement. For this reason, great caution during conversations with a guarantor will remain necessary even if the bill becomes law. There must be no promise or representation to release the guarantor or cancel the guaranty, regardless of whether the promise or representation is made verbally or in writing.

Court of Appeals Gives Further Guidance on Waivers of Requirement to Confirm Real Estate Foreclosures

In the recent case of *Apex Bank v. Thompson*, the Court of Appeals of Georgia provided helpful discussion of loan document provisions that are insufficient to waive the requirement that a lender obtain judicial confirmation of a foreclosure sale before pursuing a deficiency judgment.

The loan at issue in the case involved a promissory note given by two individuals and a limited liability company, a security deed given by the company, and a security agreement signed by both individuals providing a security interest in deposit accounts. When the borrowers defaulted on the loan, the bank foreclosed on the real property collateral and purchased the collateral for a price less than the balance of the debt. The bank did not attempt to obtain a court order confirming the foreclosure sale, but instead filed suit against the two individuals to recover a deficiency judgment.

The individuals sought to have the lawsuit dismissed on the basis that the bank was precluded from seeking a deficiency because the foreclosure was never judicially confirmed as required by Georgia law. In opposition, the bank contended that provisions in the loan documents were sufficient to waive the confirmation requirement. When the trial court refused to dismiss the case or grant judgment to the bank, the parties appealed.

On appeal, the bank focused on two provisions in the note, both of which are commonly found in vendor-provided note forms, as bases for waiver. First, the note stated that in the event of default the bank could release or foreclose on any collateral, and apply any sale proceeds, in any order chosen by the bank. Second, the note stated that a change in

terms of the note would not release any borrower or guarantor from liability.

The Court held that neither of these provisions was a sufficient waiver. With respect to the first provision, granting the lender discretion to choose whether to foreclose, or choose the order of foreclosure where multiple collateral items are involved, does not indicate the borrower's agreement that confirmation is unnecessary if and when foreclosure does occur. Similarly, as to the second, an agreement to remain liable in the event of change of note terms is not the same as an agreement to remain liable following foreclosure if confirmation is not obtained. Thus, the bank could not rely on the note to avoid having to confirm foreclosure.

The bank also sought to rely on language in the security agreement pledging deposit accounts as collateral. First, the security agreement stated that the individuals would remain liable for the debt no matter what action the bank takes, or fails to take, under the security agreement. The Court held this language was irrelevant, as the bank's foreclosure on the real property was not an action under the security agreement, but instead an action under a separate security deed.

The second security agreement provision relied on by the bank was a closer question for the Court. That provision stated that the individuals waived any defenses that may arise due to the action or inaction of the bank, including actions taken with respect to the deposit account collateral. The Court acknowledged that if the provision were construed broadly, it would apply to defenses arising in relation to any other collateral—such as the confirmation defense. However, it could also reasonably be construed to apply only to defenses relating to the security agreement itself.

Given the ambiguity, the Court ruled it was appropriate to construe the language narrowly rather than to extend the individuals' liability "by implication or interpretation." As such, the conformation requirement was not waived in the security agreement, and the bank was barred from obtaining a deficiency judgment following the foreclosure.

While the *Apex Bank* decision is not groundbreaking, it does provide more clarity as to the types of language a bank can rely upon to avoid the requirement of confirming a foreclosure. The waiver provision should squarely address confirmation, or a broader category of defenses that clearly includes confirmation. While we still have no indication that the waiver must be in any particular document (e.g., the guaranty) or in a stand-alone document, the waiver should not be in a document that is clearly intended to serve some distinct purpose or subject matter. *Apex Bank* suggests courts should be unwilling to stretch or mold unrelated provisions, or thinly-related provisions, into an effective waiver.

Overdraft Fee Litigation: Appeals Court Strikes Account Agreement Clause Barring Class-Action Lawsuits

The recent opinion by the Georgia Court of Appeals in *SunTrust Bank v. Bickerstaff* is a good example of how small details of an agreement can have a major impact. The case involved a class-action lawsuit by SunTrust customers alleging that overdraft fees imposed by the bank amounted to usury. The bank argued that the suit could not proceed as a class action because the "rules and regulations" incorporated into its account agreements with customers prohibited the customers from pursuing class-action, rather than individual, lawsuits. The trial court found the provision barring class-action lawsuits unenforceable, and the bank appealed.

The result of the appeal turned on the specific structure of the agreement. The prohibition of class-action litigation was not, as a concept, unenforceable. However, the sentence that prohibited class-action suits was located in a paragraph titled "Jury Trial Waiver" that also featured sentences purporting to waive the customers' rights to trial by jury. These sentences *were* unenforceable, as Georgia law forbids contractual waiver of jury trial rights. The Court ruled that the impermissible jury trial waiver required the entire paragraph, not merely the impermissible waiver sentences, to be stricken from the agreement. Thus, the otherwise enforceable class-action provision was no longer part of the account agreement, and was not an impediment to the lawsuit proceeding as a class action.

Understanding the UCC-1: Georgia's Special Priority Rules for Growing Crops

Georgia's priority rules for security interests in growing crops can be a challenge to understand and apply. The baseline rule for growing crops, as with most types of collateral, is that "the first to file wins"—in other words, the perfected creditor with the earliest-filed UCC-1 financing statement is entitled to senior priority. So long as this rule applies, priority can be predicted from a search of the appropriate county's deed records (remember, perfection in growing crops is accomplished by filing in the deed records, rather than the UCC records).

The exception to the baseline rule is more complicated. Under this exception, a perfected creditor is subordinated to a later-filing secured production-money creditor (whether in the form of a lender extending funds or a seller providing goods or services on credit) if the competing secured obligations fall within certain parameters as to timing and usage of credit extended.

To better recognize scenarios where priority is vulnerable to subsequent creditors, it is helpful to view the requirements for the exception as a set of four elements that must each be present in order to transcend the usual first-to-file rule of priority:

1. The subsequent production-money creditor must perfect its interest. The exception only applies if the subsequent production-money creditor is properly perfected. If it fails to properly perfect by filing, the earlier-filed creditor will have senior priority in the crops, regardless of how the debtor used the credit extended and regardless of when the crops were planted.

2. The credit provided by the subsequent creditor must have been used to enable the debtor to produce the crop that is subject to the security interest. To the extent the credit was used for some other purpose, the earlier-filed creditor will have senior priority. The subsequent creditor does not qualify as a production-money creditor.

3. The credit provided by the subsequent production-money creditor must have been extended no earlier than three months before planting of the crop that is subject to the security interest. To the extent credit was extended by the subsequent production-money creditor more than three months before planting, the usual first-to-file rule of priority will apply. The earlier-filed creditor will have senior priority regardless of how the debtor used any credit extended by either competing creditor.

4. The obligation owing to the earlier-filed creditor must have been incurred more than six months before planting of the crop that is subject to the security interest. To the extent the debt owing to the earlier-filed creditor was incurred fewer than six months before planting, the usual first-to-file rule will apply and the later filing production-money creditor cannot obtain priority under the exception. Again, this is true regardless of how the debtor used any credit extended by either creditor.

A perfected lender that hopes to rely on the first-to-file rule of priority has little or no control over whether the first three elements of the exception will be present for a subsequent competing creditor. But where extending credit for the upcoming crop year, the lender should keep the fourth element in mind. So long as the obligation to the lender was incurred within six months prior to planting, the priority exception will not be available to subsequent competing creditors.

The fourth element will ordinarily (and is intended to) protect priority of the earliest-filed production lender except where its credit was extended for a prior year's crop. But in a case where credit is extended extremely early for the upcoming year, and planting is late—leaving more than six months between the credit extension and planting—the lender could find itself subject to the security interests of later-filing suppliers or lenders. With this increased risk of priority loss in mind, the six-month window preceding the end of the likely planting time should be, except in rare cases, viewed as the earliest permissible time for advances.

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