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TO: SOUTH DAKOTA BANKS

FROM: BRET AFDAHL, Division Counsel

RE: GUARANTY AGREEMENTS

Over the years there has been a certain amount of confusion regarding the issue of loan guarantees, the liability assumed by a guarantor, and the effect these guarantees have on a bank’s lending limit. It appears that the Division likely has contributed to the confusion on this issue in guidance issued in 1993 and again in May of 2000. After further discussions and additional research, it has become apparent that the Division did not take into account certain legal precedence in South Dakota on the topic.

South Dakota law defines the term “guaranty” as “a promise to answer for the debt, default, or miscarriage of another person.” See SDCL 56-1-1. A guarantor of payment or performance, created by language such as “an absolute and unconditional” guarantee, is liable immediately upon the default of the principal. SDCL 56-1-16. All guarantees are presumed to be unconditional unless the terms of the guaranty impose some condition on the liability of the guarantor. SDCL 56-1-15. Default of the principal debtor is not considered a condition, rather, it is the underlying assumption of the guarantee agreement which creates a secondary liability, not a primary obligation.

The South Dakota Supreme Court has weighed in on the guarantee issue and has stated: “a guaranty creates a secondary liability or responsibility to pay only if another does not. International Multifoods Corporation v. Mardian, 379 NW2d 840, 843 (SD 1985). The intent of the parties control the determination of the type of obligation created if there is an ambiguity, or uncertainty, in the language of the agreement(s). The Court went on to state that the documents should be interpreted to give “that effect which shall best accord with the intentions of the parties, as manifested by the terms of the documents, taken in connection with the subject-matter to which it relates.” Id. at 844.

The Court did not specify exactly what constitutes a clear intent to create a secondary obligation on behalf of a guarantor, but a guarantee document separate and apart from the loan contract would seem to be a good starting point. If a combined loan contract and guaranteed agreement is used, the language must clearly indicate that the obligation being created on behalf of the guarantor is secondary to that of the primary debtor.
In an earlier case, the Court stated that simply using the term “guaranty” by itself may not be enough to presume that an agreement is in fact a true guarantee, due to the various uses for that one term in commerce. Rather, the Court indicated that if necessary, it would look to the facts and circumstances that surround the agreement to “determine whether an original and independent obligation, rather than a mere guaranty was intended.” Western Petroleum Company v. First Bank Aberdeen, 367 NW2d 773, 777 (SD 1985).

This Memorandum supersedes all prior guidance issued by the Division on the same topic. As a result, unless the language or intent of the parties to a guaranty contract are unclear or ambiguous, there will be no further requirement of a bank to insert language specifying that default by a borrower must occur before a guarantor is liable. As stated above, if the agreement is properly drafted, default is presumed in the concept of the secondary obligation created by a guaranty contract. Finally, any amount guaranteed that meets the requirements described above, will be excluded from calculating the loan or credit limitation contained in SDCL 51A-12-2.