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CORPORATE LAW

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Guarantors' Contribution Agreement

Is personal liability on a guaranty proportionate to stock ownership?

This is a common scenario in the business world. Art owns 50 percent and Bill and Charlie each own 25 percent of the stock in ABC Corp. ABC Corp. borrows $100,000 from the Bank. ABC Corp. signs a promissory note and Art, Bill and Charlie sign a joint and several personal guaranty.

ABC Corp. is unable to repay the promissory note. The Bank looks to Art, Bill and Charlie on their personal guaranty for repayment of the $100,000. Art, Bill and Charlie now dispute their percentage liability on the personal guaranty.

When they signed the personal guaranty, Bill and Charlie were each under the impression that among the stockholders, their own personal liability would be limited to $25,000 each. They believed that their personal liability on the guaranty would be proportionate to their stock ownership interest in ABC Corp. That is, they each own 25 percent of the stock of ABC Corp.; therefore, they should be liable for 25 percent of the debt.

Art, however, argues that their stock ownership in ABC Corp. is irrelevant. Art contends that based on their personal guaranty, he, Bill and Charlie are each liable for one-third of the $100,000.

Who is right? Is Art liable for $50,000, and are Bill and Charlie each liable for $25,000? Or are the three of them each liable for $33,333?

Parenthetically, as far as the Bank is concerned, they are jointly and severally liable and the Bank can go after all of them or any one of them for the entire $100,000. Even if one of them pays the entire $100,000, he can go after the others for contribution (i.e., reimbursement), which brings us back to the question posed above.

Bill and Charlie will be surprised to learn that the law supports Art. In general, co-guarantors are equally liable on the personal guaranty; therefore, Bill and Charlie are each liable for 33 percent, not 25 percent, of the debt. See, e.g., *D'Ippolito v. Castoro*, 51 N.J. 584, 589-90 (1968); *Republic Business Credit Corp. v. Camhe-Marcille*, 381 N.J.Super. 563, 569-570 (App. Div. 2005); *Thomas v. Gardner*, 187 N.J. Super. 510, 514-515 (App. Div. 1983). See also Restatement of the Law Third, Suretyship and Guaranty, § 57(a) and Comment "a," Illustration No. 1 (1996).

In the context of business owners who guarantee the debts of their business entity, the law provides that their proportionate liability is based on the joint and several personal guaranty and not on their respective ownership interests in the business entity. For example, in one case, *Brill v. Swanson*, 674 P.2d 211, 212 (Wash. App. 1984), the court held that "as co-guarantors on a corporate note, the parties were not liable to one another in proportion to their stock ownership in the corporation." Instead, they were equally liable.

In another case, *Slutsky v. Leftt*, 160 Misc. 2d 959, 961 (N.Y.C. Civ. Ct. 1993), the court held that "Since the three co-guarantors were liable to [the bank] both jointly and severally, there was a presumption that they bear the burden equally." Therefore, in the absence of any written evidence that their liability would be in proportion to their ownership interest, the court concluded that "each guarantor is liable for one-third of the debt."

Finally, in *Byrd v. Estate of Nelms*, 154 S.W.3d 149, 165 (Tex. App. 2004), the court held that "Absent an express agreement among guarantors to the contrary, the contributive share of [any one guarantor] is limited to the total amount of liability divided by the number of co-guarantors."

There is some authority to the contrary, but it relies upon a finding of an *implicit* agreement among the guarantors that their respective personal liability is based upon their respective percentage equity ownership interest. See Restatement of the Law Third, Suretyship and Guaranty, § 57, Comment "c," Illustration No. 4 (1996).

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What can business owners, and their attorneys, do to address this situation? Art, Bill and Charlie can enter into a contribution agreement that provides that among the three of them, their respective personal liability is limited to their stock ownership percentage in ABC Corp. In other words, if any one of them makes a payment on the guaranty, then the others will reimburse him so that they will have each paid an amount based upon their respective percentage ownership interest in ABC Corp. For example:

> If any party makes a payment with respect to the Guaranty, then each of the other parties shall be unconditionally obligated to reimburse the paying party with a payment in such an amount so that after such payment, each of the parties will be liable on the Guaranty in an amount based upon their stock ownership percentage in ABC Corp.

The contribution agreement would also address other issues, such as the notice to be provided to the other parties, the time to make the reimbursement payment, and similar issues. At a minimum, the agreement will memorialize the parties' understanding that their respective personal liability on the guaranty is based upon their respective equity ownership percentage in the business entity. ■