

GUARANTY AND SURETYSHIP LAW – WHETHER AN INDIVIDUAL MAY AVOID OBLIGATIONS UNDER A PERSONAL GUARANTY CONTRACT WHEN A COMPANY CONVERTS TO A DIFFERENT ORGANIZATIONAL FORM

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Wasserberg v. Flooring Servs. of Tex., LLC, 376 S.W.3d 202 (Tex. App.—Houston [14th Dist.] 2012, no pet. h.).

What is a Personal Guaranty?

A guaranty agreement between parties creates a secondary obligation that is separate from a primary obligor's promise to pay.¹ The secondary obligation is comprised of a promise by the guarantor to be responsible for the primary obligor's debt.² Upon failure of the primary obligor to pay their share of the contract, the guarantor in the guaranty agreement is liable for the debt.³

A recent case from the Fourteenth Court of Appeals of Texas took another look at the qualifications for personally guaranteeing the debts of a company and the repercussions of doing so for individuals.⁴ The court in *Wasserberg* held that the individuals were personally liable for the debts owed by the corporation because they had executed a valid guaranty agreement.⁵ Although the defendants cited other cases where the personal guaranties were insufficient, the court distinguished between the case at hand, and the cases cited; finding that the defendants' arguments were insufficient.⁶

Test for a Guaranty Contract

The test to recover under a guaranty contract requires a showing of:

- (1) The existence and ownership of a guaranty contract;
- (2) The terms of the underlying contract by the holder;
- (3) The occurrence of the conditions upon which liability is based; and
- (4) The failure or refusal to perform the promise by the guarantor.⁷

Under the rule of *strictissimi juris*, a guarantor is entitled to have the terms of the guaranty agreement be strictly construed and not interpreted beyond its terms.⁸ In order to ap-

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¹ *Wasserberg v. Flooring Servs. of Tex., LLC*, 376 S.W.3d 202, 205 (Tex. App.—Houston [14th Dist.] 2012, no pet. h.)

² *Id.*

³ *Id.*

⁴ *See generally id.*

⁵ *Id.* at 209.

⁶ *Id.* at 207.

⁷ *Id.* at 205.

⁸ *Id.* at 206; *see also* *McKnight v. Va. Mirror Co.*, 463 S.W.2d 428, 430 (Tex. 1971) (explaining how a guarantor is permitted to rely on the terms of the contract being strictly followed, and thus if the terms of the guaranty are changed, the guarantor will no longer be liable because a new contract has essentially been formed).

ply such a rule, the court must first ascertain the terms of the agreement by reviewing the language of the guaranty de novo.⁹

The validity of a guaranty agreement does not cease to exist upon conversion of a limited liability company to a limited partnership.¹⁰ In Texas, upon conversion of an entity, the entity simply continues to exist without interruption in the new organizational form rather than in its prior.¹¹ A personal guarantor may not escape liability merely because an entity changes its name or form.¹²

Wasserberg's Approach

The case of *Wasserberg* arose when Jonathan Wasserberg and Jason Felt personally guaranteed any debt owed by Waterhill Companies Limited (WCL) in their individual capacities in order to obtain a line of credit with Flooring Services of Texas, LP (FST).¹³ When FST was unable to obtain payment from WCL, FST brought suit against WCL for payments due, as well as against Wasserberg and Felt based on their personal guaranties.¹⁴ The underwriter of the title insurance policies, Stewart Title, also sued seeking indemnity from Wasserberg for amounts of settled claims on the liens on behalf of the homeowners.¹⁵ The affidavits Wasserberg signed allegedly made him “personally liable for any damages resulting from [falsified] information [with]in the affidavits.”¹⁶ In order to avoid liability, Wasserberg and Felt argued that the guaranty contracts were insufficient due to a lack of express language that named the companies for which they would be liable.¹⁷

The issue before the court was whether conversion of organizational forms discharges individuals of their obligations to repay any debt incurred by the company as a result of the personal guaranty contracts that they signed.¹⁸ The court found that prior cases, and the Texas Business Organization Code supported the finding that such conversion does not affect the liability of an individual who signed an affidavit and who created a guaranty contract agreeing to take on such responsibility.¹⁹ The court addressed three arguments in its reasoning for holding the defendants liable.²⁰

First, the court found that the Texas Business Organization Code does not permit the guaranty contracts created for one entity to cease to exist simply because that entity converts its form of liability or changes its name.²¹ So long as the company drafts a plan of conversion prior to implementation, any personal guaranty contracts relating to the prior company will carry over to the new company.²² The court further stated that there was no evidence that Wasserberg and Felt’s debt at issue was incurred on behalf of Waterhill Company, LLC (the original company) and that the guaranties were applicable to any debts incurred after Waterhill Company, LLC converted to WCL, LP.²³

⁹ *Wasserberg*, 376 S.W.3d at 206.

¹⁰ *Id.* at 207.

¹¹ *Id.* at 206 (citing TEX. BUS. ORGS. CODE ANN. § 10.106 (West 2011)).

¹² *Id.* at 207.

¹³ *Id.* at 204.

¹⁴ *Id.*

¹⁵ *Id.* at 204–05.

¹⁶ *Id.* at 205.

¹⁷ *Id.*

¹⁸ *Id.*

¹⁹ *Id.* at 206–07.

²⁰ See generally *id.*

²¹ See TEX. BUS. ORGS. CODE ANN. §§ 10.103, 10.106 (West 2011).

²² *Id.*

²³ *Wasserberg*, 376 S.W.3d at 207.

Second, the court found that specific language permitting the succession or assignment of a guaranty is not necessary for its enforcement.²⁴ The plaintiffs relied on two cases, *Marshall* and *Gifford-Hill*, to support their argument; but the court distinguished said cases from the case at hand.²⁵ In *Marshall*, the court held that it could only enforce the contract according to its precise terms and could not extend beyond.²⁶ Because the guaranty contract at hand expressly states that no unpaid labor would remain, *Marshall* is distinguished from the guaranty contract in this case, and Wasserberg remains liable for the debt.²⁷ In *Gifford-Hill*, the court determined that express language was not required despite the court finding that the contract was insufficient.²⁸

Finally, the court addressed the fact that Wasserberg admitted that he signed the affidavits regarding debts owed and that the plaintiffs gave no additional evidence to merit an affirmative defense pleading.²⁹ The affidavit stated that all bills were paid and that there would be no unpaid labor or material claims against the improvements or the property.³⁰ Upon signing such an affidavit, Wasserberg expressly represented their affirmation of his guaranty to the company.³¹ The court found that Wasserberg had no defense available to him to relieve him of his obligations because to testify otherwise would be fraud.³² Defendants' argument that the trial court erred by not permitting them to give additional testimony was irrelevant and overruled.³³

The court's reasoning led to its conclusion that the guaranty clause was valid and enforceable against the personal guarantors, and that the creditors were able to enforce it.³⁴ The conversion of the organizational form of the company did not adversely affect the enforceability of the guaranty contract made by the personal guarantors on behalf of the company.³⁵ By upholding the enforcement of the guaranty contract, the court was not extending the contract's terms beyond its strict enforcement because the guaranty was made with regard to any and all debts that the company sustained, rather than being limited to specific goods and services that were provided by the original creditor.³⁶

What Does This Mean To You?

Wasserberg is significant for several reasons, but most importantly it supports the near-absolute validity of personal guaranty contracts. For practicing attorneys in Texas, this case gives guidance as to how future courts in Texas may rule on this issue, and has affirmed prior cases that have upheld personal guaranties for the same reasons.³⁷ Furthermore, this case emphasizes the notion that practicing attorneys should advise their clients to be specific when drafting guaranty contracts and expressly state the terms. The reason is because the court appears to favor upholding personal guaranties, rather than extinguishing obligations due to tech-

²⁴ *Id.* at 208.

²⁵ *Id.* at 207–08.

²⁶ *Id.* at 207 (citing *Marshall v. Ford Motor Co.*, 878 S.W.2d 629, 631 (Tex. App.—Dallas 1994, no writ)).

²⁷ *Id.* at 208.

²⁸ *Id.* (citing *Peters v. Gifford-Hill & Co.*, 794 S.W.2d 856, 860 (Tex. App.—Dallas 1994, writ denied)).

²⁹ *Id.* at 208.

³⁰ *Id.*

³¹ *Id.*

³² *Id.* at 209.

³³ *Id.*

³⁴ *Id.*

³⁵ *Id.*

³⁶ *Id.*

³⁷ See also *Tenneco Oil Co. v. Gulshy Eng'g, Inc.*, 846 S.W.2d 599, 605 (Tex. App.—Houston [14th Dist.] 1993, writ denied); *Marshall*, 878 S.W.2d at 630; *Gifford-Hill*, 794 S.W.2d at 863 (all illustrating rulings and policies consistent with the holding in *Wasserberg*).

nicalities, such as changes in a company's organizational form or lack of naming the newly formed company in the personal guaranty contract.