


VEDDER PRICE

The Practical Lender

A bulletin devoted to highlighting the practical effects of law on the finance business. The  denotes practical lender tips for the lender.

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SPOUSAL GUARANTORS' DEFENSE UNDER THE EQUAL CREDIT OPPORTUNITY ACT

Introduction

The Equal Credit Opportunity Act, 15 U.S.C. §1691 *et seq.* ("ECOA"), was enacted in 1974 to protect consumers from discrimination in the extension of credit by financial institutions. Contained within the ECOA is a provision, known as the Spousal Guarantors' Defense, which can prove detrimental to the unwary commercial lender. The recent Bankruptcy Court decision in *In Re Farris*, 194 B.R. 931 (Bankr. E.D. Pa. 1996), exemplifies the potential "sting" of this defense.

The Spousal Guarantors' Defense

The use of the ECOA as a potential defense to payment by the spouse of a borrower who executes a guarantee or other debt instrument at the request of the lender was at issue in *Farris*. The spousal guarantor in *Farris* was "an unemployed housewife" with no assets in her own name (other than the marital residence), who did not own any stock and was not employed by and was not an officer or director of any of her husband's businesses. Her husband, the one seeking a commercial loan for one of his business enterprises, was an experienced business- person who owned interests in several different companies and real estate properties. The lender required the wife to execute a note for the husband's loan in 1986, and the wife sought to void the obligation ten years later as a violation of the ECOA.

In relevant part, the ECOA makes it unlawful for any creditor to discriminate against any applicant, with respect to any aspect of a credit transaction, on the basis of marital status. Regulation B sets forth the general rule, which bars

a lender from requiring a nonapplicant spouse to sign a debt instrument when the applicant is independently creditworthy.



Spousal Guarantors' Defense: A Lender violates the ECOA if it requires a married applicant's spouse to cosign a loan or debt instrument even though the applicant is qualified individually under the Lender's standards for creditworthiness.

Exceptions to the Spousal Guarantors' Defense

Exceptions to the general rule are provided in Regulation B: (i) a creditor can require the signature on a guarantee or debt instrument of a "joint applicant"; (ii) applicant requests unsecured credit and relies in part upon property owned jointly with another to satisfy the creditor's standards of creditworthiness; (iii) married applicant requests unsecured credit and resides in a community property state; and (iv) applicant requests secured credit and the spouse's signature is necessary or reasonably believed by the creditor to be necessary under applicable law to make the collateral being offered by the applicant available to satisfy the debt in the event of a default (*e.g.*, mortgage held in joint tenancy).

Based upon the evidence presented in *Farris*, the Court concluded that the husband/applicant independently qualified as creditworthy for the subject loan, and that the wife was not a joint applicant. Accordingly, the lender's request that the wife execute the debt instrument was a violation of the ECOA, and the obligation was not enforceable against the wife. The lender's requirement, however, that the wife execute the mortgage of the marital residence offered as collateral for the husband's loan did not violate the ECOA, under the exception described above which allows for the signature "on any instrument necessary or reasonably believed by the creditor as necessary, under applicable state law to make the property being offered as security available to satisfy the debt in the event of default..." The mortgage on the marital residence, therefore, was enforceable, even though the guaranty was unenforceable.



Lender should recite the reasons and consideration for the spousal guaranty in the applicable documents to evidence the applicability of an exception to the Spousal Guarantors' Defense.

Damages

In the event of a violation under the ECOA, most courts suggest that the spousal guarantor can use the violation as an affirmative defense against the enforcement of the guarantee or other debt instrument, or seek affirmative relief under the ECOA for damages, costs, attorneys' fees and punitive damages, which, unlike an affirmative defense, typically are barred by the passage of a two-year statute of limitations.

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Independent action for affirmative relief under the ECOA, e.g., actions for damages, costs, attorneys' fees, are subject to a two-year statute of limitations. No such statute of limitations exists for defensive assertions of the ECOA.

Any creditor who violates the ECOA could be liable to the aggrieved applicant for any actual damages and for punitive damages in an amount not greater than \$10,000. In addition, a Court may grant such "equitable and declaratory relief as is necessary to enforce the requirements imposed" under the ECOA. Furthermore, in the case of any successful action, the costs of the action, together with a reasonable attorney's fee as determined by the Court, shall be added to damages awarded by the Court.

Conclusion

If you would like information about any finance topic, including further information on the Spousal Guarantors' Defense, please contact the Vedder Price Finance Group practice leader, [Michael Nemeroff](#), at (312/609-7858) in Chicago, [Ron Scheinberg](#) at (212/407-7730) in New York or any Vedder Price attorney with whom you have worked. The contributing author of this article is Robert Patton.

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