



Does the Equal Credit Opportunity Act Apply to Spousal Guarantors? Yes and No!

Often, a trade creditor extending credit to its customer will require additional security in the form of a guaranty of its customer's obligations. A creditor considering obtaining a spousal guaranty must contend with the requirements of the Equal Credit Opportunity Act (ECOA) and its accompanying Regulation B.

Recently, two United States Circuit Courts of Appeal have reached conflicting holdings on whether the ECOA and Regulation B apply to spousal guaranties. The United States Sixth Circuit Court of Appeals, in its recent 2014 decision in *RL BB Acquisition, LLC v. Bridgemill Commons Development Group, LLC, et al.*, held that a spouse providing a guaranty is an applicant subject to the ECOA and Regulation B. However, shortly after the Sixth Circuit's decision, on August 5, 2014 the United States Eighth Circuit Court of Appeals, in *Hawkins v. Community Bank of Raymore*, reached the opposite conclusion, refusing to apply the protections afforded by the ECOA and Regulation B to a spousal guaranty.

The courts will continue to grapple with this issue and trade creditors should proceed very carefully and follow Regulation B's requirements relating to spousal guaranties.

The United States Supreme Court will eventually have to weigh in to resolve the split between the Circuit Courts of Appeal on the applicability of the ECOA and Regulation B to a spousal guaranty. Until then, the courts will continue to grapple with this issue and trade creditors should proceed very carefully and follow Regulation B's requirements relating to spousal guaranties.

The ECOA and Regulation B

Pursuant to the ECOA, it is "unlawful for any creditor to discriminate against any *applicant*, with respect to any aspect of a credit transaction...on the basis of marital status."¹ Only applicants with respect to any aspect of a credit transaction can sue for ECOA violations. Creditors violating the ECOA and Regulation B are subject to claims for recovery of actual damages, punitive damages and attorneys' fees.



The ECOA defines the term applicant as "any person who applies to a creditor directly for an extension, renewal, or continuation of credit, or applies to a creditor indirectly by use of an existing credit plan for an amount exceeding a previously established credit limit."² Thus, the ECOA applies to applicants for credit. However, the ECOA's definition of applicant does not include guarantors.

The ECOA also granted authority to the agency charged with overseeing the statute, first the Federal Reserve Board and now the Consumer Financial Protection Bureau, to adopt regulations to implement the ECOA. Regulation B, adopted by the Federal Reserve, defines the term applicant to include guarantors. The portion of Regulation B that is at issue in the Sixth Circuit and Eighth Circuit cases, known as the "spousal guarantor" rule, prohibits a creditor from requiring an applicant's spouse to execute a guaranty, even where the creditor requires a guaranty.³

The Sixth Circuit, relying on Regulation B's definition of applicant that includes guarantors, held that the ECOA and Regulation B are applicable to spousal guaranties. However, the Eighth Circuit reached the opposite conclusion, holding that a guarantor is not entitled to any of the protections of the ECOA or Regulation B because guarantors are not included in the ECOA's definition of applicant.

The Sixth Circuit Case

H. Bernard Dixon invested in Bridgemill Commons and Mabry Farms, two residential developments in Atlanta. As a result of the financial crisis in 2008, the developments had nearly \$10 million in debt requiring

refinancing, \$3.2 million attributable to Mabry Farms owed to United Community Bank (the UCB loan) and \$6.4 million attributable to Bridgemill Commons owed to Regions Bank (the Regions loan). Bernard sought to refinance the debt on both developments with BB&T Bank.

Bridgemill Commons Development Group Inc. (BCDG) was the borrower on the Regions loan. BB&T determined that Bridgemill Commons was worth only \$5.65 million, less than the outstanding balance due on the Regions loan. Based on this information, BB&T Bank concluded that Bernard and BCDG were not independently creditworthy for a loan large enough to refinance both the Regions loan and the UCB loan. BB&T was willing to refinance the Regions loan if Bernard provided additional collateral.

Bernard and his wife Starr Stone Dixon (Starr) each agreed to pledge 40,000 shares of BB&T stock as additional collateral for payment of the Regions loan. However, the additional collateral Bernard and Starr had offered was still insufficient to refinance the Regions loan.⁴

In response, both Bernard and Starr executed personal guaranties in favor of BB&T. It was unclear exactly what transpired before Starr had agreed to execute her guaranty, but Starr testified that she was pressured to execute her guaranty, albeit not by BB&T. The refinancing transaction closed on June 4, 2008 and BCDG issued a note in the amount of \$6.4 million to BB&T that came due on June 5, 2010. BB&T subsequently assigned the BCDG note to RL BB Acquisition, LLC (plaintiff).

On August 21, 2011, the plaintiff filed a lawsuit in the United States District Court for the Eastern District of Tennessee to collect the sums due on the BCDG note and the guarantees executed by Bernard and Starr. In response, Starr asserted that her guaranty was unenforceable because it violated the ECOA and Regulation B, particularly Regulation B's spousal guarantor rule. The District Court held that Starr could not rely on violations of the ECOA and Regulation B as an affirmative defense and that Starr was liable to plaintiff under her guaranty. Starr appealed the District Court's ruling.

The Sixth Circuit ruled that the ECOA's definition of applicant is not straightforward and is broad enough to include a guarantor. The court also upheld Regulation B's definition of applicant that includes guarantors and concluded that a guarantor can assert ECOA claims. The court observed that Congress had promulgated the ECOA to eradicate credit discrimination against woman, especially married women who creditors had traditionally refused to consider for individual credit.

The Sixth Circuit recognized that it had to decide two issues. First, should the court give deference to Regulation B's definition of applicant that includes guarantors where the ECOA's definition of applicant does not include guarantors? Second, can a spouse providing a guarantee raise a violation of the ECOA and Regulation B as an affirmative defense?

The Sixth Circuit applied a two part test promulgated by the United States Supreme Court in *Chevron U.S.A, Inc. v. Natural Resources Defense Council* (the "Chevron Test") to determine whether to defer to Regulation B's definition of the term applicant. First, the court must determine whether the ECOA's definition of applicant is clear or ambiguous. If the meaning of applicant is found to be ambiguous, the court must then decide whether the Federal Reserve's definition of applicant in Regulation B fills a gap left by Congress or defines applicant in a manner consistent with Congress' intent.

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The Sixth Circuit, addressing the first part of the Chevron Test, held that the ECOA's definition of the term applicant is ambiguous and could be interpreted to include third parties who did not initiate an application for credit, and who do not seek credit for themselves, a category that includes guarantors. The court relied on Webster's Dictionary's definition of applies which means "to make an appeal or request esp[ecially] formally and often in writing and usu[ally] for something of benefit to oneself" and Oxford Dictionary's meaning of applies, which is "[t]o make an approach to (a person) for information or aid; to have recourse or make application to, to appeal to; to make a (formal) request for."

While the Sixth Circuit recognized that a guarantor does not usually directly approach a creditor to obtain credit, the court observed that a guarantor does formally approach a creditor in the sense that the guarantor offers up her own personal liability to the creditor if the borrower defaults. The court refused to narrowly interpret the ECOA's definition of applicant to include only the initial applicant seeking credit (the interpretation adopted by the Eighth Circuit). The ECOA's definition of an applicant could just as easily encompass those who offer promises in support of the application, including guarantors, who make formal requests for aid in the form of credit for a third party. Likewise, since the ECOA prohibits discrimination with respect to "any aspect of a credit transaction", the court did not think it was appropriate to limit the meaning of the term applicant to exclude guarantors.⁵

After deciding that the ECOA's definition of applicant is ambiguous, the Sixth Circuit considered whether Regulation B was an appropriate exercise of the Federal Reserve's regulatory authority. The court gave deference to the Federal Reserve's interpretation of applicant because Regulation B's inclusion of guarantors in the definition of applicant is "at least one of the natural meanings" of the term.

The Sixth Circuit next considered whether a spouse providing a guaranty can assert ECOA violations as an affirmative

defense in an action to recover the sums owing on the guaranty. Some courts have held that ECOA violations can only be raised as a counterclaim and not as an affirmative defense. Other courts, including the United States Courts of Appeal for the First and Third Circuits, have held that ECOA violations can be raised as an affirmative defense. Still other courts have held that ECOA violations could only be asserted through the affirmative defense of illegality, which would void the spousal guaranty.

First, the court must determine whether the ECOA's definition of applicant is clear or ambiguous.

The Sixth Circuit held that a violation of the ECOA could be raised as an affirmative defense. Neither the ECOA nor Regulation B explicitly hinders a defendant's ability to assert violations of the ECOA and Regulation B as an affirmative defense. The Sixth Circuit then remanded the action to the District Court to consider the merits of the underlying case. The court instructed the District Court to determine whether (a) the creditor required the signature of the applicant's spouse despite the fact that the applicant was independently credit-worthy, or (b) the creditor "required that the spouse be the additional party because the applicant party, when considered individually, was determined to need support of an additional party? Notably, the court observed that Starr had the burden of proving that BB&T required *her* to provide a guaranty and would not accept the guaranty of another third party.

The Eighth Circuit Case

PHC Development, LLC was a Missouri limited liability company with two members, Gary Hawkins and Chris Patterson. Valerie Hawkins was married to Gary Hawkins and Janice Patterson was married to Chris Patterson. Neither Ms. Hawkins nor Ms. Patterson had any legal interest in PHC. During 2005 to 2008, Community Bank of Raymore had made four separate loans, totaling more than \$2 million to PHC. PHC's two members, Hawkins and Patterson and their wives (the spousal guarantors), executed personal guarantees in favor of Community for each loan and reaffirmed their guarantees as part of each modification of the loans.

In April, 2012, Community declared the loans to be in default after PHC had failed to make the required payments. Community also accelerated the loans and demanded payment from PHC and all of the guarantors. Shortly thereafter, the spousal guarantors filed an action in the United States District Court for the Western District of Missouri - Kansas City, seeking damages and a declaration that their guarantees were void and unenforceable under the ECOA. The spousal guarantors alleged that Community had violated the ECOA by requiring their guarantees because the spousal guarantors were married to Hawkins and Patterson. In response, Community filed several state law counterclaims, including claims for breach of the guarantees. The spousal guarantors asserted, as an affirmative defense in response to the counterclaims,

that their guarantees were unenforceable because PHC had obtained them in violation of the ECOA.

Community moved for summary judgment and the District Court dismissed the spousal guarantors' ECOA claims because the spousal guarantors were not applicants under the ECOA. On appeal, the spousal guarantors, relying on Regulation B, argued that they were applicants within the meaning of the ECOA because they had guaranteed PHC's debt to Community.

The Eighth Circuit held that the spousal guarantors are not applicants, and, therefore, are not entitled to the protections of the ECOA and Regulation B. The Court also applied the Chevron Test in refusing to defer to Regulation B's definition of applicant (that includes guarantors). The Eighth Circuit did not need to go past the first part of the Chevron Test, holding that the text of the ECOA clearly provides that a person does not qualify as an applicant under the statute solely by virtue of

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executing a guaranty to secure the debt of another. The court focused on the meaning of the word apply in the ECOA's definition of applicant. In order for someone to apply for credit, that person must request credit. A guarantor does not, by solely executing a guaranty, *request credit*, as a guaranty is instead a promise to answer for another person's debt, default or failure to perform, or, in other words, "an undertaking by a guarantor to answer for payment of some debt, or performance of some contract, of another person in the event of default."⁶ It is unambiguous that assuming a secondary, contingent liability does not amount to a request for credit. A guarantor engages in different conduct, receives different benefits, and is exposed to different legal consequences than a credit applicant.

Moreover, the Eighth Circuit focused on the purposes and policies underlying the ECOA. The Court observed that the ECOA was initially designed, at least in part, to curtail the practice of creditors who refused to grant a wife's credit application without a guaranty from her husband. Another purpose was to forbid a creditor to deny credit to a woman on the basis of a belief that she would not be a good credit risk because she would be distracted by child care or some other stereotypically female responsibility. These policies sought to ensure the fair access to credit and not exclude borrowers from the credit market based on marital status. However, the court noted that these policies do not apply to the spousal

guarantors because they are neither excluded from the lending process nor denied access to credit. In fact, to the contrary, the spousal guarantors argued that they were being *improperly included* in the credit process.

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Finally, the Eighth Circuit noted that under Missouri law, husbands and wives that co-own property are presumed to own the property as tenants by the entirety. As such, the request for the spousal guarantors to execute their guarantees was done to enable Community to reach marital assets, which the court regarded as “sound commercial practice unrelated to any stereotypical view of a wife’s role.”

Accordingly, the Eighth Circuit held that the spousal guarantors were not applicants under the ECOA and Community did not violate the ECOA by requiring them to execute their guarantees.

Conclusion

The conflicting holdings of the Sixth and Eighth Circuit Courts of Appeal clearly demonstrate why trade creditors seeking additional security through a spousal guarantee must proceed cautiously. Until the United States Supreme Court weighs in on whether the term applicant includes guarantors, parties seeking a spousal guaranty should continue to follow Regulation B’s requirements or seek alternative security for payment of their claims. ■

1. See 15 U.S.C. Section 1691(a) (emphasis added).

2. See 15 U.S.C. Section 1691a(b).

3. Another portion of the “spouse guarantor” rule prohibits creditors from “requir[ing] the signature of an applicant’s spouse, . . . other than a joint applicant, on any credit instrument if the applicant qualifies under the creditor’s standards of creditworthiness for the amount and terms of the credit requested.” See Regulation B, § 202.7(d)(1). There are also limited exceptions, cited by the Sixth Circuit, where (a) the applicant requires unsecured credit and is relying, in part, upon property that applicant and spouse jointly own, and (b) where a married applicant requests unsecured credit and resides in a community property state, or if the property on which the applicant is relying in its credit decision, is located in a community property state. See Regulation B, §§ 202.7(d) (2) and (3).

4. Based on BB&T’s underwriting criteria, the collateral package Bernard and Starr had offered to BB&T only supported a loan totaling \$6.1 million—still less than the balance due on the Regions Loan.

5. 15 U.S.C. Section 1691a.

6. See 38 Am. Jur. 2d Guaranty § 1 (2014).

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