Handout
ISB CLE on Debt Financing November 12, 2014
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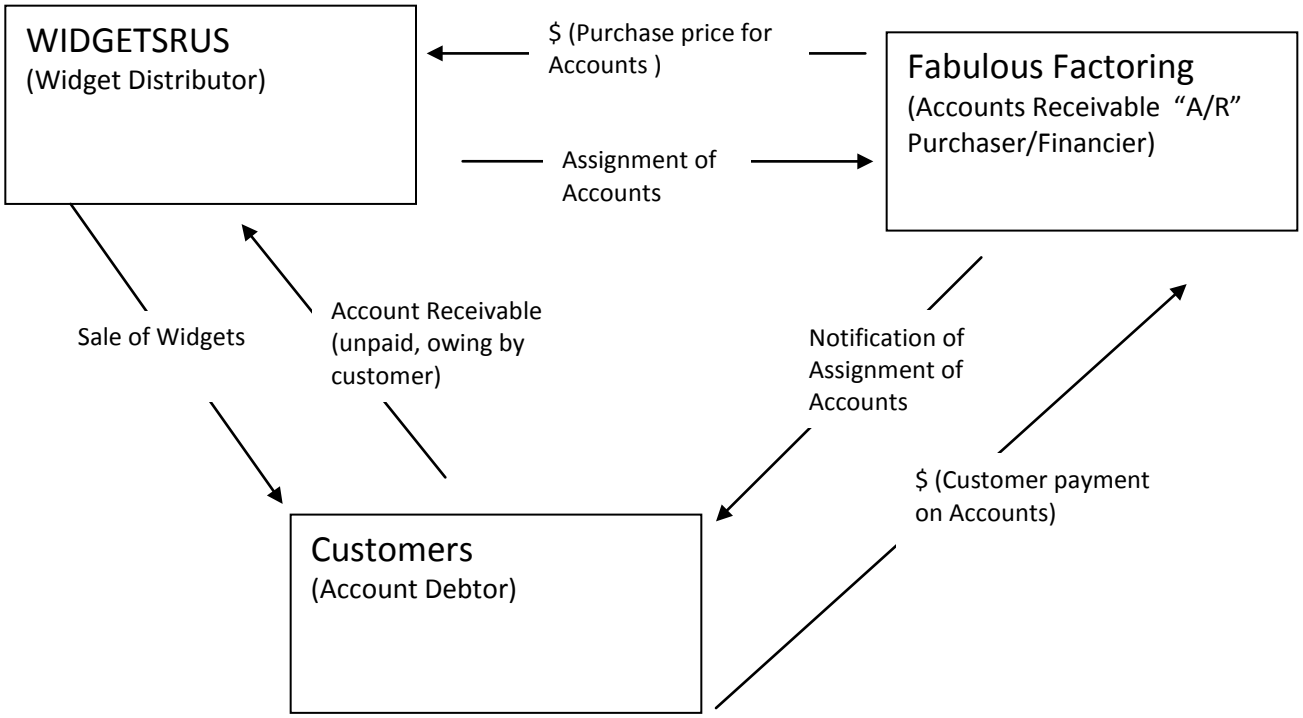
A. The Early days

Bob Businessman is the founder and owner of a small closely held corporation, WidgetsRUs. WidgetsRus had been in the business of distributing Widgets of various manufacturers in the Boise area. But Bob had recently developed significant Widget improvements and was having its own line of SuperWidgets manufactured for it to distribute. Things are going well, with good sales of the new SuperWidget line. But Bob is having some trouble with managing his cash flow. He needs to pay his contract manufacturing supplier regularly, but some of the customers are paying too slowly.

Bob has received a financing proposal from Fabulous Factoring. Bob calls Larry Lawyer to get his advice.

Bob Businessman

Larry Lawyer



Both assignments of accounts and grants of security interest are governed by Article 9 of the uniform commercial code.

28-1-201, Idaho Code (no non-uniform provisions):

(35) "Security interest" includes any interest of a consignor and a buyer of accounts, chattel paper, a payment intangible, or a promissory note in a transaction that is subject to chapter 9, title 28, Idaho Code. "Security interest" does not include the special property interest of a buyer of goods on identification of those goods to a contract for sale under section 28-2-401, Idaho Code, but a buyer may also acquire a "security interest" by complying with chapter 9, title 28, Idaho Code. Except as otherwise provided in section 28-2-505, Idaho Code, the right of a seller or lessor of goods under chapter 2 or chapter 12, title 28, Idaho Code, to retain or acquire possession of the goods is not a "security interest," but a seller or lessor may also acquire a "security interest" by complying with chapter 9, title 28, Idaho Code. The retention or reservation of title by a seller of goods notwithstanding shipment or delivery to the buyer under section 28-2-401, Idaho Code, is limited in effect to a reservation of a "security interest." Whether a transaction in the form of a lease creates a "security interest" is determined pursuant to section 28-1-203, Idaho Code.

28-9-109, Idaho Code

Scope. (a) Except as otherwise provided in subsections (c) and (d), this chapter applies to:
(1) A transaction, regardless of its form, that creates a security interest in personal property or fixtures by contract;
(2) An agricultural lien;
(3) A sale of accounts, chattel paper, payment intangibles or promissory notes;
(4) A consignment;
(5) A security interest arising under section 28-2-401, 28-2-505, 28-2-711(3) or 28-12-508(5), as provided in section 28-9-110; and
(6) A security interest arising under section 28-4-210 or 28-5-120.

Provisions prohibiting assignment or requiring consent are generally unenforceable by the customer with respect to account receivable, and assignment won't constitute a default under the customer agreement.

28-9-406(d) Idaho Code

(d) Except as otherwise provided in subsection (e) of this section and sections 28-9-407 and 28-12-303, Idaho Code, and subject to subsection (h) of this section, a term in an agreement between an account debtor and an assignor or in a promissory note is ineffective to the extent that it:
(1) Prohibits, restricts or requires the consent of the account debtor or person obligated on the promissory note to the assignment or transfer of, or the creation, attachment, perfection or enforcement of a security interest in, the account, chattel paper, payment intangible or promissory note; or
(2) Provides that the assignment or transfer or the creation, attachment, perfection, or enforcement of the security interest may give rise to a default,

breach, right of recoupment, claim, defense, termination, right of termination, or remedy under the account, chattel paper, payment intangible or promissory note.

After notification of a customer (ie obligor of receivable) of the assignment of the receivable, the customer will owes the assignee, not the assignor

28-9-406(a) Idaho Code

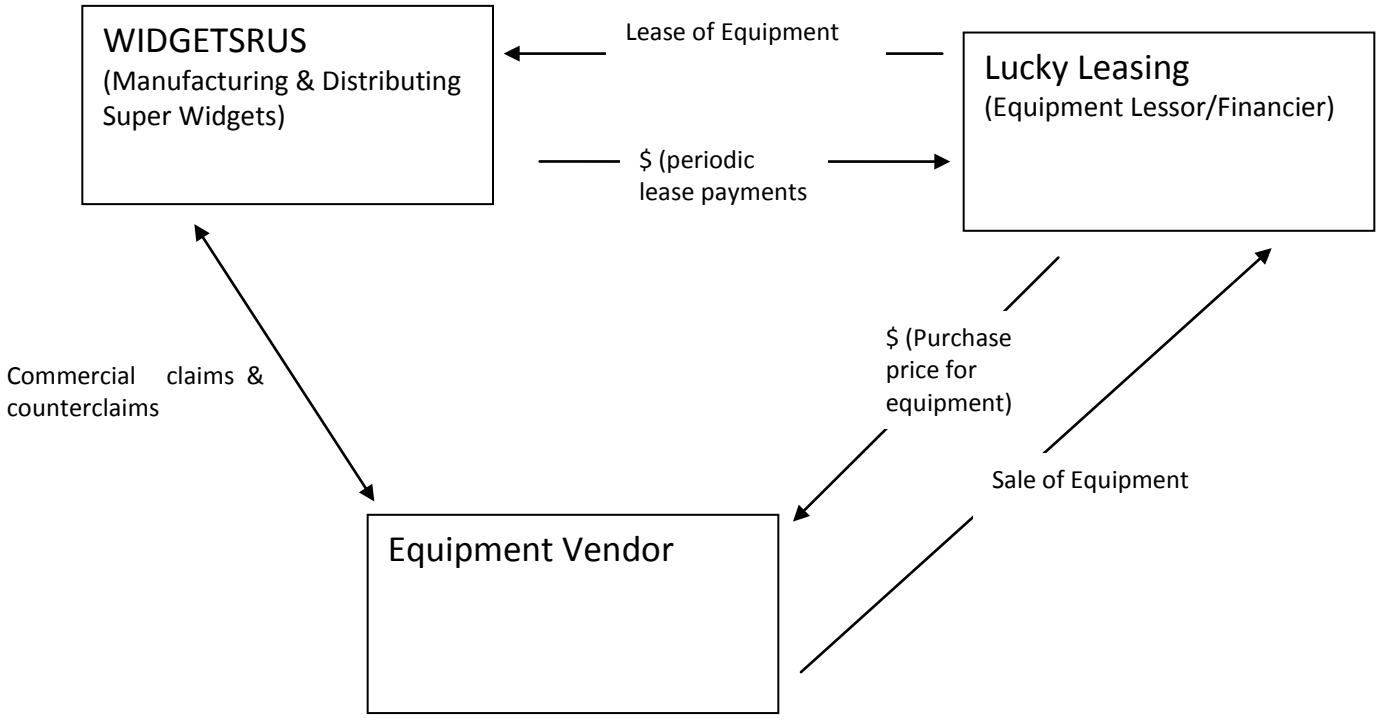
(a) Subject to subsections (b) through (i) of this section, an account debtor on an account, chattel paper or a payment intangible may discharge its obligation by paying the assignor until, but not after, the account debtor receives a notification, authenticated by the assignor or the assignee, that the amount due or to become due has been assigned and that payment is to be made to the assignee. After receipt of the notification, the account debtor may discharge its obligation by paying the assignee and may not discharge the obligation by paying the assignor.

B. WidgetsRUS Expands into Manufacturing

The SuperWidget line that Bob introduced is selling very well, but Bob has bigger plans for WidgetsRUs. He hasn't been satisfied with the performance of his contract manufacturer and wants to control the production of his product directly. He acquires empty factory space at a discount price and prepares to expand his company into manufacturing. And again Bob calls Larry for help.

Bob Businessman

Larry Lawyer



A lease can either be structured as a "true lease" or really be a secured loan in the form of lease.

28-1-203 Idaho Code:

28-1-203. Lease distinguished from security interest. (a) Whether a transaction in the form of a lease creates a lease or security interest is determined by the facts of each case.
(b) A transaction in the form of a lease creates a security interest if the consideration that the lessee is to pay the lessor for the right to possession and use of the goods is an obligation for the term of the lease and is not subject to termination by the lessee, and:
(1) The original term of the lease is equal to or greater than the remaining economic life of the goods;
(2) The lessee is bound to renew the lease for the remaining economic life of the goods or is bound to become the owner of the goods;
(3) The lessee has an option to renew the lease for the remaining economic life of the goods for no additional consideration or for nominal additional consideration upon compliance with the lease agreement; or
(4) The lessee has an option to become the owner of the goods for no additional consideration or for nominal additional consideration upon compliance with the lease agreement.
(c) A transaction in the form of a lease does not create a security interest merely because:
(1) The present value of the consideration the lessee is obligated to pay the lessor for the right to possession and use of the goods is substantially equal to or is greater than the fair market value of the goods at the time the lease is entered into;
(2) The lessee assumes risk of loss of the goods;
(3) The lessee agrees to pay, with respect to the goods, taxes, insurance, filing, recording, or registration fees, or service or maintenance costs;
(4) The lessee has an option to renew the lease or to become the owner of the goods;
(5) The lessee has an option to renew the lease for a fixed rent that is equal to or greater than the reasonably predictable fair market rent for the use of the goods for the term of the renewal at the time the option is to be performed; or
(6) The lessee has an option to become the owner of the goods for a fixed price that is equal to or greater than the reasonably predictable fair market value of the goods at the time the option is to be performed.
(d) Additional consideration is nominal if it is less than the lessee's reasonably predictable cost of performing under the lease agreement if the option is not exercised. Additional consideration is not nominal if:
(1) When the option to renew the lease is granted to the lessee, the rent is stated to be the fair market rent for the use of the goods for the term of the renewal determined at the time the option is to be performed; or
(2) When the option to become the owner of the goods is granted to the lessee, the price is stated to be the fair market value of the goods determined at the time the option is to be performed.
(e) The "remaining economic life of the goods" and "reasonably predictable" fair market rent, fair market value, or cost of performing under the lease agreement

must be determined with reference to the facts and circumstances at the time the transaction is entered into.

Article 9 of the UCC contains provisions protecting rights of secured debtors not just secured creditors.

Commercially Reasonable Disposition of Collateral

28-9-610. Disposition of collateral after default. (a) After default, a secured party may sell, lease, license or otherwise dispose of any or all of the collateral in its present condition or following any commercially reasonable preparation or processing.
(b) Every aspect of a disposition of collateral, including the method, manner, time, place, and other terms, must be commercially reasonable. If commercially reasonable, a secured party may dispose of collateral by public or private proceedings, by one (1) or more contracts, as a unit or in parcels, and at any time and place and on any terms.
(c) A secured party may purchase collateral:
(1) At a public disposition; or
(2) At a private disposition only if the collateral is of a kind that is customarily sold on a recognized market or the subject of widely distributed standard price quotations.
(d) A contract for sale, lease, license, or other disposition includes the warranties relating to title, possession, quiet enjoyment, and the like which by operation of law accompany a voluntary disposition of property of the kind subject to the contract.
(e) A secured party may disclaim or modify warranties under subsection (d) of this section:
(1) In a manner that would be effective to disclaim or modify the warranties in a voluntary disposition of property of the kind subject to the contract of disposition; or
(2) By communicating to the purchaser a record evidencing the contract for disposition and including an express disclaimer or modification of the warranties.
(f) A record is sufficient to disclaim warranties under subsection (e) of this section if it indicates "There is no warranty relating to title, possession, quiet enjoyment, or the like in this disposition" or uses words of similar import.

28-9-627. Determination of whether conduct was commercially reasonable. (a) The fact that a greater amount could have been obtained by a collection, enforcement, disposition or acceptance at a different time or in a different method from that selected by the secured party is not of itself sufficient to preclude the secured party from establishing that the collection, enforcement, disposition or acceptance was made in a commercially reasonable manner.
(b) A disposition of collateral is made in a commercially reasonable manner if the disposition is made:
(1) In the usual manner on any recognized market;
(2) At the price current in any recognized market at the time of the disposition; or
(3) Otherwise in conformity with reasonable commercial practices among dealers in the type of property that was the subject of the disposition.

(c) A collection, enforcement, disposition or acceptance is commercially reasonable if it has been approved:
(1) In a judicial proceeding;
(2) By a bona fide creditors' committee;
(3) By a representative of creditors; or
(4) By an assignee for the benefit of creditors.
(d) Approval under subsection (c) of this section need not be obtained, and lack of approval does not mean that the collection, enforcement, disposition or acceptance is not commercially reasonable.

Application of proceeds, debtor right to surplus proceeds.

28-9-615. Application of proceeds of disposition -- Liability for deficiency and right to surplus. (a) A secured party shall apply or pay over for application the cash proceeds of disposition under section 28-9-610 in the following order to:

(1) The reasonable expenses of retaking, holding, preparing for disposition, processing and disposing, and, to the extent provided for by agreement and not prohibited by law, reasonable attorney's fees and legal expenses incurred by the secured party;

(2) The satisfaction of obligations secured by the security interest or agricultural lien under which the disposition is made;

(3) The satisfaction of obligations secured by any subordinate security interest in or other subordinate lien on the collateral if:

(A) the secured party receives from the holder of the subordinate security interest or other lien an authenticated demand for proceeds before distribution of the proceeds is completed; and

(B) in a case in which a consignor has an interest in the collateral, the subordinate security interest or other lien is senior to the interest of the consignor; and

(4) A secured party that is a consignor of the collateral if the secured party receives from the consignor an authenticated demand for proceeds before distribution of the proceeds is completed.

(b) If requested by a secured party, a holder of a subordinate security interest or other lien shall furnish reasonable proof of the interest or lien within a reasonable time. Unless the holder does so, the secured party need not comply with the holder's demand under subsection (a)(3) of this section.

(c) A secured party need not apply or pay over for application noncash proceeds of disposition under section 28-9-610 unless the failure to do so would be commercially unreasonable. A secured party that applies or pays over for application noncash proceeds shall do so in a commercially reasonable manner.

(d) If the security interest under which a disposition is made secures payment or performance of an obligation, after making the payments and applications required by subsection (a) of this section and permitted by subsection (c) of this section:

(1) Unless subsection (a)(4) of this section requires the secured party to apply or pay over cash proceeds to a consignor, the secured party shall account to and pay a debtor for any surplus; and

(2) The obligor is liable for any deficiency.

(e) If the underlying transaction is a sale of accounts, chattel paper, payment intangibles or promissory notes:

(1) The debtor is not entitled to any surplus; and

(2) The obligor is not liable for any deficiency.

(f) The surplus or deficiency following a disposition is calculated based on the amount of proceeds that would have been realized in a disposition complying with this part to a transferee other than the secured party, a person related to the secured party, or a secondary obligor if:

(1) The transferee in the disposition is the secured party, a person related to the secured party or a secondary obligor; and

(2) The amount of proceeds of the disposition is significantly below the range of proceeds that a complying disposition to a person other than the secured party, a person related to the secured party, or a secondary obligor would have brought.

(g) A secured party that receives cash proceeds of a disposition in good faith and without knowledge that the receipt violates the rights of the holder of a security interest or other lien that is not subordinate to the security interest or agricultural lien under which the disposition is made:

(1) Takes the cash proceeds free of the security interest or other lien;

(2) Is not obligated to apply the proceeds of the disposition to the satisfaction of obligations secured by the security interest or other lien; and

(3) Is not obligated to account to or pay the holder of the security interest or other lien for any surplus.

Debtor consent post-default required for creditor to keep collateral.

28-9-620. Acceptance of collateral in full or partial satisfaction of obligation -- Compulsory disposition of collateral. (a) A secured party may accept collateral in full or partial satisfaction of the obligation it secures only if:

(1) The debtor consents to the acceptance under subsection (c) of this section;

(2) The secured party does not receive, within the time set forth in subsection (d) of this section, a notification of objection to the proposal authenticated by:

(A) a person to which the secured party was required to send a proposal under section 28-9-621; or

(B) any other person, other than the debtor, holding an interest in the collateral subordinate to the security interest that is the subject of the proposal; and

(3) Subsection (e) of this section does not require the secured party to dispose of the collateral or the debtor waives the requirement pursuant to section 28-9-624.

(b) A purported or apparent acceptance of collateral under this section is ineffective unless:

(1) The secured party consents to the acceptance in an authenticated record or sends a proposal to the debtor; and

(2) The conditions of subsection (a) of this section are met.

(c) For purposes of this section:

(1) A debtor consents to an acceptance of collateral in partial satisfaction of the obligation it secures only if the debtor agrees to the terms of the acceptance in a record authenticated after default; and

(2) A debtor consents to an acceptance of collateral in full satisfaction of the obligation it secures only if the debtor agrees to the terms of the acceptance in a record authenticated after default or the secured party:

(A) sends to the debtor after default a proposal that is unconditional or subject only to a condition that collateral not in the possession of the secured party be preserved or maintained;

(B) in the proposal, proposes to accept collateral in full satisfaction of the obligation it secures; and

(C) does not receive a notification of objection authenticated by the debtor within twenty (20) days after the proposal is sent.

(d) To be effective under subsection (a)(2) of this section, a notification of objection must be received by the secured party:

(1) In the case of a person to which the proposal was sent pursuant to section 28-9-621, within twenty (20) days after notification was sent to that person; and

(2) In other cases:

(A) within twenty (20) days after the last notification was sent pursuant to section 28-9-621; or

(B) if a notification was not sent, before the debtor consents to the acceptance under subsection (c) of this section.

(e) A secured party that has taken possession of collateral shall dispose of the collateral pursuant to section 28-9-610 within the time specified in subsection (f) of this section if:

(1) Sixty percent (60%) of the cash price has been paid in the case of a purchase-money security interest in consumer goods; or

(2) Sixty percent (60%) of the principal amount of the obligation secured has been paid in the case of a nonpurchase-money security interest in consumer goods.

(f) To comply with subsection (e) of this section, the secured party shall dispose of the collateral:

(1) Within ninety (90) days after taking possession; or

(2) Within any longer period to which the debtor and all secondary obligors have agreed in an agreement to that effect entered into and authenticated after default.

Bankruptcy provisions aiding true lessors: See 11 U.S. Code Section 365.

Sample "Hell or High Water" Lease Provision:

12. NET LEASE. Lessee is unconditionally obligated to pay all rent and other amounts due during the entire lease Term no matter what happens, even if the Equipment is damaged or destroyed, if it is defective or if Lessee no longer can use it. Lessee is not entitled to reduce or set-off against rent or other amounts due to Lessor or to anyone to whom Lessor assigns this Agreement or any Schedule whether Lessee's claim arises out of this Agreement, any Schedule, any statement by Lessor, Lessor's liability or any manufacturer's liability, strict liability, negligence or otherwise; provided, that this Section 12 shall not prevent Lessee from bringing a separate claim against Lessor for breach of this Agreement.

"Hell or High Water" Provisions Enforceable, extends to assignees.

28-12-407. Irrevocable promises -- Finance leases. (1) In the case of a finance lease that is not a consumer lease the lessee's promises under the lease contract become irrevocable and independent upon the lessee's acceptance of the goods.

(2) A promise that has become irrevocable and independent under the provisions of subsection (1) of this section:

(a) Is effective and enforceable between the parties, and by or against third parties including assignees of the parties; and

(b) Is not subject to cancellation, termination, modification, repudiation, excuse or substitution without the consent of the party to whom the promise runs.

(3) The provisions of this section do not affect the validity under any other law of a covenant in any lease contract making the lessee's promises irrevocable and independent upon the lessee's acceptance of the goods.

Sample Lease Assignment Provision:

11. ASSIGNMENT. LESSEE SHALL NOT SELL, TRANSFER, ASSIGN, ENCUMBER OR SUBLET ANY EQUIPMENT OR THE INTEREST OF LESSEE IN THE EQUIPMENT WITHOUT THE PRIOR WRITTEN CONSENT OF LESSOR (WHICH CONSENT, IN THE CASE OF SUBLEASING ONLY, SHALL NOT BE UNREASONABLY WITHHELD, CONDITIONED OR DELAYED). Lessor may, without the consent of Lessee, assign this Agreement, any Schedule or the right to enter into a Schedule; provided, that, no such assignment shall be to a competitor of Lessee (it being understood that any regulated financial institution or its leasing affiliate, or any investment fund, insurance company or other funding source engaged principally in the business of making loans or investments, shall not be deemed a competitor) without Lessee's prior written consent. Lessee agrees that if Lessee receives written notice of an assignment from Lessor, Lessee will pay all rent and all other amounts payable under any assigned Schedule to such assignee or as reasonably instructed by Lessor. Lessee also agrees to confirm in writing receipt of the notice of assignment as may be reasonably requested by assignee. Lessee hereby waives and agrees not to assert against any such assignee any defense, set-off, recoupment claim or counterclaim which Lessee has or may at any time have against Lessor for any reason whatsoever.

Waiver of defenses by account debtor enforceable by assignee

28-9-403. Agreement not to assert defenses against assignee. (a) In this section, "value" has the meaning provided in section 28-3-303(1).

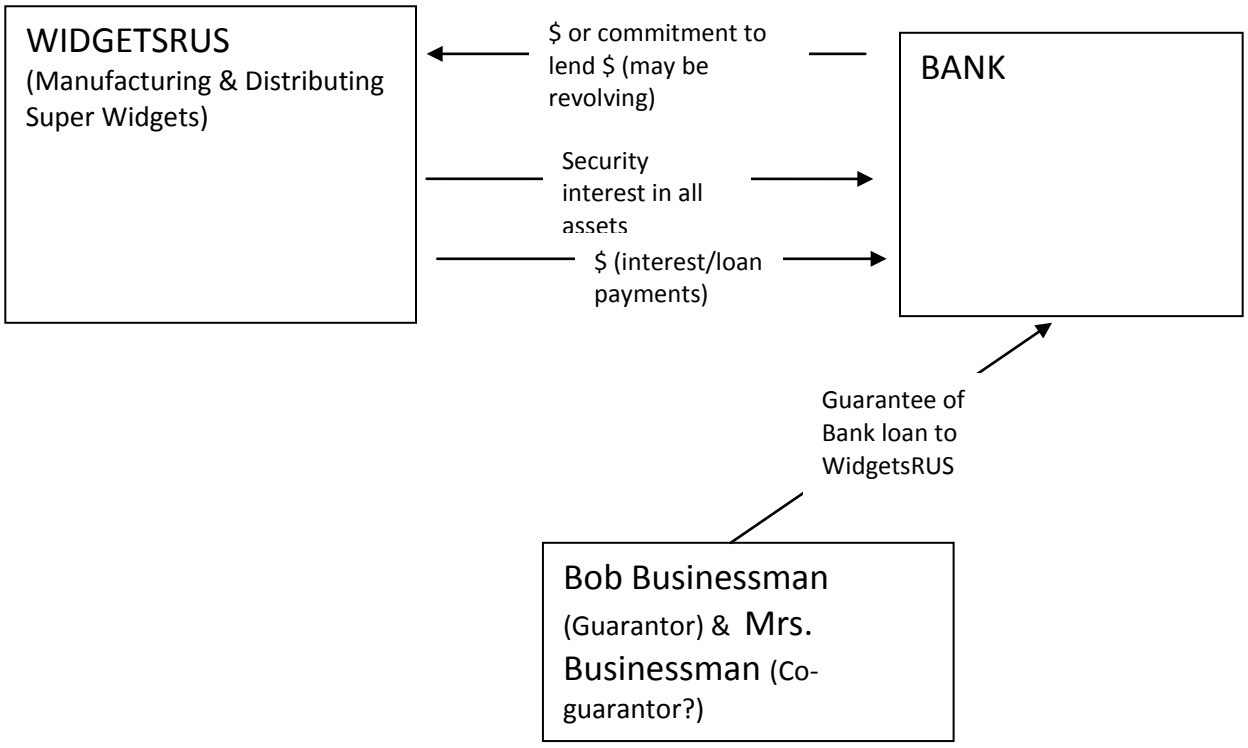
(b) Except as otherwise provided in this section, an agreement between an account debtor and an assignor not to assert against an assignee any claim or defense that the account debtor may have against the assignor is enforceable by an assignee that takes an assignment:
(1) For value;
(2) In good faith;
(3) Without notice of a claim of a property or possessory right to the property assigned; and
(4) Without notice of a defense or claim in recoupment of the type that may be asserted against a person entitled to enforce a negotiable instrument under section 28-3-305(1).
(c) Subsection (b) of this section does not apply to defenses of a type that may be asserted against a holder in due course of a negotiable instrument under section 28-3-305(2).
(d) In a consumer transaction, if a record evidences the account debtor's obligation, law other than this chapter requires that the record include a statement to the effect that the rights of an assignee are subject to claims or defenses that the account debtor could assert against the original obligee, and the record does not include such a statement:
(1) The record has the same effect as if the record included such a statement; and
(2) The account debtor may assert against an assignee those claims and defenses that would have been available if the record included such a statement.
(e) This section is subject to law other than this chapter which establishes a different rule for an account debtor who is an individual and who incurred the obligation primarily for personal, family or household purposes.
(f) Except as otherwise provided in subsection (d) of this section, this section does not displace law other than this chapter which gives effect to an agreement by an account debtor not to assert a claim or defense against an assignee.

C. WidgetsRUS Seeks a Bank Credit Facility

WidgetsRUs continues to prosper and expand and Bob doesn't think the financing from Fabulous Factoring and Lucky Leasing is sufficient. And again Bob calls Larry for some advice.

Bob Businessman

Larry Lawyer



Guidance On Regulation B Spousal Signature Requirements

This guidance provides information on the rules governing spousal signatures as they relate to extensions of credit, including business credit.[1] (For reference, see the attached chart depicting the regulatory requirements concerning spousal signatures.)

I. ECOA and Regulation B.

The Equal Credit Opportunity Act, 15 U.S.C. § 1691 *et seq*., prohibits creditors from discriminating against credit applicants on the basis of race, color, religion, national origin, sex, marital status, age (provided the applicant has the capacity to contract), or because an applicant receives income from a public assistance program or has in good faith exercised any right under the Consumer Credit Protection Act. The Federal Reserve Board's Regulation B at 12 C.F.R. Part 202 implements ECOA, and the staff's official interpretations are incorporated in Part 202, Supp. I.

II. General Rule.

Under Regulation B, § 202.7(d)(1), generally a creditor may not require the signature of an applicant's spouse or any other person (other than a joint applicant) on any *credit* instrument if the applicant qualifies for the amount and terms of the credit requested under the creditor's standards of creditworthiness.[2] This rule applies to all open-end and closed-end, secured and unsecured extensions of consumer credit and business credit.[3]

If an applicant does not meet the creditor's standards of creditworthiness, then the creditor may condition approval of the credit application upon the applicant either (1) furnishing the signature of another person (cosigner, guarantor or similar person), but the creditor may not require that person to be the applicant's spouse,[4] or (2) securing the credit extension with sufficient collateral (or in the case of an application for secured credit, additional collateral) to satisfy the creditor's standards.[5] Therefore, if a creditor routinely requires spousal guarantees, for example, without first ascertaining whether an applicant is creditworthy, then the conditioning of the loan on the spousal guarantee violates § 202.7(d)(1).

III. Exceptions to the General Rule.

There are three exceptions to the general prohibition against requiring signatures of non-applicant spouses for creditworthy applicants under § 202.7(d)(1). A creditor is permitted to take into account state property laws that directly or indirectly affect an applicant's creditworthiness.[6]

1. **Unsecured credit-non-community property state:** If an applicant requests unsecured credit and relies in part on property the applicant owns jointly with the applicant's spouse to satisfy the creditor's standards of creditworthiness, the creditor may under § 202.7(d)(2) require the signature of the applicant's spouse only on the instrument(s) necessary, or reasonably believed by the creditor to be necessary,[7] under the law of the state in which the property is located, to enable the creditor to reach the property being relied upon in the event of the death or default of the applicant.[8]

   NOTE: Some states' property laws treat married applicants differently from unmarried applicants in a way that affects their creditworthiness. For example, several states provide that real property and/or personal property acquired by married persons jointly is owned as tenants by the entirety (i.e., where neither spouse would be able to commit any interest in the property without the signature of the other spouse on the promissory note), unless specified otherwise. In such states, if state law so provides, a creditor

could require the signature of the non-applicant spouse on the promissory note where the creditor relies upon real property and/or personal property owned by the applicant and the applicant's spouse as tenants by the entirety in order to qualify the applicant for the loan.

2. **Unsecured credit-community property state:** If a married applicant requests unsecured credit and resides in a community property state, *or* if the property upon which the applicant is relying is located in such a state, the creditor may under § 202.7(d)(3) require the signature of the applicant's spouse on any instrument necessary, or reasonably believed by the creditor to be necessary,[9] under applicable state law, to make the community property available to satisfy the debt in the event of default if:

   (i) applicable state law denies the applicant power to manage or control sufficient community property to qualify for the amount of credit requested; and

   (ii) the applicant does not have sufficient separate property to qualify for the amount of credit requested without regard to community property.[10,11]

   NOTE: Section 202.5(c)(2)(iv) permits a creditor to request any information concerning an applicant's spouse (or former spouse) that the creditor could request about the applicant under certain circumstances, including when the applicant requests unsecured credit affected by community property laws.

3. **Secured credit:** If an applicant requests secured credit, a creditor may under § 202.7(d)(4) require the signature of the applicant's spouse on any instrument necessary, or reasonably believed by the creditor to be necessary,[12] under applicable state law, to make the property being offered as security available to satisfy the debt in the event of default (*e.g.,* an instrument creating a valid lien).[13]

   NOTE: A signature is generally only needed on a security instrument. If applicable state law requires both spouses to sign the promissory note (or other credit instrument) in order to create an enforceable security interest, then the creditor may do so.[14]

IV. Asset Valuation.

Regulation B requires that when an applicant relies on his or her individual interest in property owned jointly with the applicant's spouse to satisfy the creditor's standards of creditworthiness, the creditor may not require the spouse's signature on any instrument as a condition of the approval of the credit extension, *unless* the applicant's interest in the property does not support the amount and the terms of the credit requested or one of the three exceptions set forth in Section III above applies.[15] The creditor must determine (and not presume) the actual form of ownership of the property prior to or at consummation of the credit transaction.[16] The possibility of subsequent changes in the form of ownership (*e.g.,* by transfer or divorce) may not be considered.[17]

The creditor is permitted in its evaluation of assets to determine whether the applicant's interests in the assets being offered are of sufficient value to protect the creditor in the event of death or default in the following way:

- If a person applies for individual credit, a decision about creditworthiness requires an institution to look at the individual's interests in the assets, including individually-owned assets, first in deciding whether it will extend credit. If the individual's interests in the assets are sufficient to satisfy the creditor's standards of creditworthiness, it is impermissible for the creditor to require any guarantor or any cosigner on the promissory note.[18] If property that an applicant offers the creditor is owned jointly with another person, the creditor may only look to the applicant's interest in the jointly

owned property and, as a general rule, cannot require the signature of the non-applicant joint owner on the promissory note.

- If, however, the applicant's interest in the jointly owned property is insufficient to protect the creditor, the creditor may require the signature of an additional person on the promissory note (but may not require it to be the spouse's signature), or may require the credit to be secured with sufficient additional collateral to satisfy the creditor's standards.
- If the non-applicant joint owner's signature is necessary for the creditor to reach the property being relied upon or offered as security by the applicant (such as with tenants by the entirety), the creditor may require the signature of the non-applicant joint owner, but only on the document necessary or reasonably believed[19] necessary by the creditor to provide adequate protections to satisfy the debt in the event of the applicant's death or default.

A creditor has broad discretion in deciding what property, if any, is required to assist in a determination about creditworthiness. For example, assuming the creditor is looking to property as opposed to income, there is no requirement that the creditor look to a certain type of property (*e.g.,* personal property over real property). The decision whether to prefer personal or real property, however, must be made in a nondiscriminatory manner. For example, a creditor may prefer real property in cases involving a married applicant only if the creditor also prefers real property in instances in which the applicant is unmarried.

The same analysis is true regarding extensions of credit for a business as set forth in Section V below.

V. Significance in Business Lending.

ECOA and Regulation B can raise particular problems for the creditor in business lending. Regulation B does not require written applications for business credit.[20] Consequently, such "applications" are often the result of several conversations (including negotiations), the submission of a financial statement(s), and a business plan(s). It is not always clear who the applicants are, what signatures are actually voluntarily offered by the applicant, and what signatures are needed by the creditor. Regulation B, clarified by the amendments in 2003, prohibits a creditor from presuming that the submission of joint financial information constitutes an application for joint credit.[21] Thus, where the financial statement lists jointly held property of a husband and wife and is signed by both spouses (attesting to the accuracy of the data), there would be ECOA and Regulation B problems if a creditor treats the financial statement as an indication that the husband and wife are making a joint application. By doing so, a creditor may find itself requiring both property owners (husband and wife) to sign the promissory note when, in fact, only the property owner who is involved with the business intends to be obligated on the extension of credit.

A person's intent to be a joint applicant must be evidenced at the time of application. Although the mere presence of two signatures on a promissory note may not be used to show an intent to apply for joint credit, signatures or initials on a written application that affirm the applicants' intent to apply for joint credit, as opposed to merely affirming the veracity of data may be used to establish an intent to apply for joint credit.[22] Where there is no written application, the applicants' intent to apply for joint credit may be evidenced, for example, by the presence in the file of a written statement by the applicants that expresses such an intent.

Even if a corporation is creditworthy, a creditor may require the personal guarantees of the partners, directors or officers of a business, and the shareholders of a closely held corporation.[23] In accordance with Regulation B, a creditor is prohibited from requiring the signature of the guarantor's spouse in the same way that it is prohibited from obtaining the signature of an applicant's spouse and the Official Commentary to Regulation B states that the signature rules of § 202.7(d) apply equally to guarantors.[24] Thus, if a creditor first determines that the guarantor is not creditworthy based upon his or her individual assets, then, in accordance with the signature rules of § 202.7(d), the creditor may require an additional signature and that signature may be required to be the guarantor's spouse's in appropriate

circumstances (i.e., in accordance with § 202.7(d)(2) (unsecured credit), § 202.7(d)(3) (unsecured credit involving community property) or § 202.7(d)(4) (secured credit)).[25] In any event, while a creditor may require officers of a business to personally guarantee the business loan, and may require the guarantee of another person in appropriate circumstances, the creditor may not automatically require that spouses of married officers also personally guarantee the loan.[26]

As previously indicated, the rules set forth in Section IV above, regarding what property a creditor may prefer, also apply to business credit. Regulation B does not require a creditor to limit its evaluation of the guarantor's creditworthiness to individually owned assets in the business lending context if (1) the guarantor's interest in individually owned assets is insufficient to protect the creditor or (2) if the joint owner's signature is necessary for the creditor to reach the property being relied upon or offered as security by the guarantor such as with tenants by the entirety. In such instances, the creditor may require the signature of the non-applicant joint owner, including a spouse, but only on the document necessary, or reasonably believed necessary by the creditor, to provide adequate protections to satisfy the debt in the event of the applicant's death or default.

Attachment: Chart of Spousal Signature Requirements

[1]This guidance augments that provided by FDIC FIL-9-2002, "Spousal Signature Provisions of Regulation B," dated February 4, 2002.

[2]The Official Staff Interpretations make it clear that, with the exception for closely held corporations, it is impermissible for a creditor to require any applicant who is individually creditworthy to provide a cosigner, even if the creditor applies the requirement without regard to any prohibited basis. Official Staff Interpretations, 12 C.F.R. pt. 202, Supp. I, Paragraph 202.7(d)(1), Comment 1, as *amended by* 68 Fed. Reg. 13,144, 13,191 (2003). All references in this guidance to Regulation B and its accompanying staff commentary take into account the Federal Reserve Board's amendments to those documents, made effective as of April 15, 2003, and with a mandatory compliance date of April 15, 2004.

[3]Although this guidance strictly relates to the requirements for "spousal" signatures, the requirements also apply to obtaining the signatures of other persons in addition to the applicant.

[4]12 C.F.R. § 202.7(d)(5) and Official Staff Interpretations at Paragraph 202.7(d), Comment 2. ECOA and Regulation B do not prohibit spouses from signing voluntarily. A creditor should leave it up to the applicant to name the additional party.

[5]Official Staff Interpretations at Paragraph 202.7(d)(2), Comment 1(ii).

[6]12 C.F.R. § 202.6(c).

[7]Regulation B requires reasonable belief to be supported by a thorough review of pertinent statutory law and decisional law or an opinion of the state attorney general. Official Staff Interpretations at Paragraph 202.7(d)(2), Comment 2.

[8]If instead of jointly owned property, the applicant is relying on the spouse's income, the creditor may require the spouse's signature to make the income available to pay the debt. Official Staff Interpretations at Paragraph 202.7(d)(5), Comment 2.

[9]Regulation B requires reasonable belief to be supported by a thorough review of pertinent statutory law and decisional law or an opinion of the state attorney general. Official Staff Interpretations at Paragraph 202.7(d)(2), Comment 2.

[10]Most community property laws specify how married couples own and control property and

who has the legal power to commit the property to support a credit application or secure a loan. A creditor may assume an applicant who applies for credit in a community property state is a resident of that state, unless the applicant indicates otherwise. Official Staff Interpretations at Paragraph 202.7(d)(3), Comment 1.

[11]If the applicant is relying on the spouse's income (including future earnings), the creditor may require the spouse's signature to make the income available to pay the debt. Official Staff Interpretations at Paragraph 202.7(d)(5), Comment 2.

[12]Regulation B requires reasonable belief to be supported by a thorough review of pertinent statutory law and decisional law or an opinion of the state attorney general. Official Staff Interpretations at Paragraph 202.7(d)(4), Comment 2.

[13]Regarding integrated notes and security agreements, see Official Staff Interpretations at Paragraph 202.7(d)(4), Comment 3.

[14]*See* Official Staff Interpretations at Paragraph 202.7(d)(4), Comments 1 and 2.

[15]*See generally,* Official Staff Interpretations at Paragraph 202.7(d)(2), Comment 1.

[16]This would require considering not only applicable law, but also any documents evidencing and/or affecting the form of ownership (e.g., a trust instrument).

[17]Official Staff Interpretations at Paragraph 202.7(d)(2), Comment 1(i).

[18] Official Staff Interpretations at Paragraph 202.7(d)(1), Comment 1, *as amended by* 68 Fed. Reg. 13,144, 13,191 (2003). An exception to this prohibition is made for guarantors of closely held corporations. See Section V of this Guidance.

[19] Regulation B requires reasonable belief to be supported by a thorough review of pertinent statutory law and decisional law or an opinion of the state attorney general. Official Staff Interpretations at Paragraph 202.7(d)(4), Comment 2.

[20]Under Regulation B, written applications are only required for credit for the purchase or refinancing of a dwelling as a principal residence. 12 C.F.R. §§ 202.5(e) (recodified as 12 C.F.R. § 202.4 (c) by 68 Fed. Reg. 13,144 (2003)), and 202.13(a). Issues raised in this section of the guidance also may occur in the consumer credit context.

[21]68 Fed. Reg. 13,144, 13,165 (2003) (*to be codified at* 12 C.F.R. § 202.7(d)(1)).

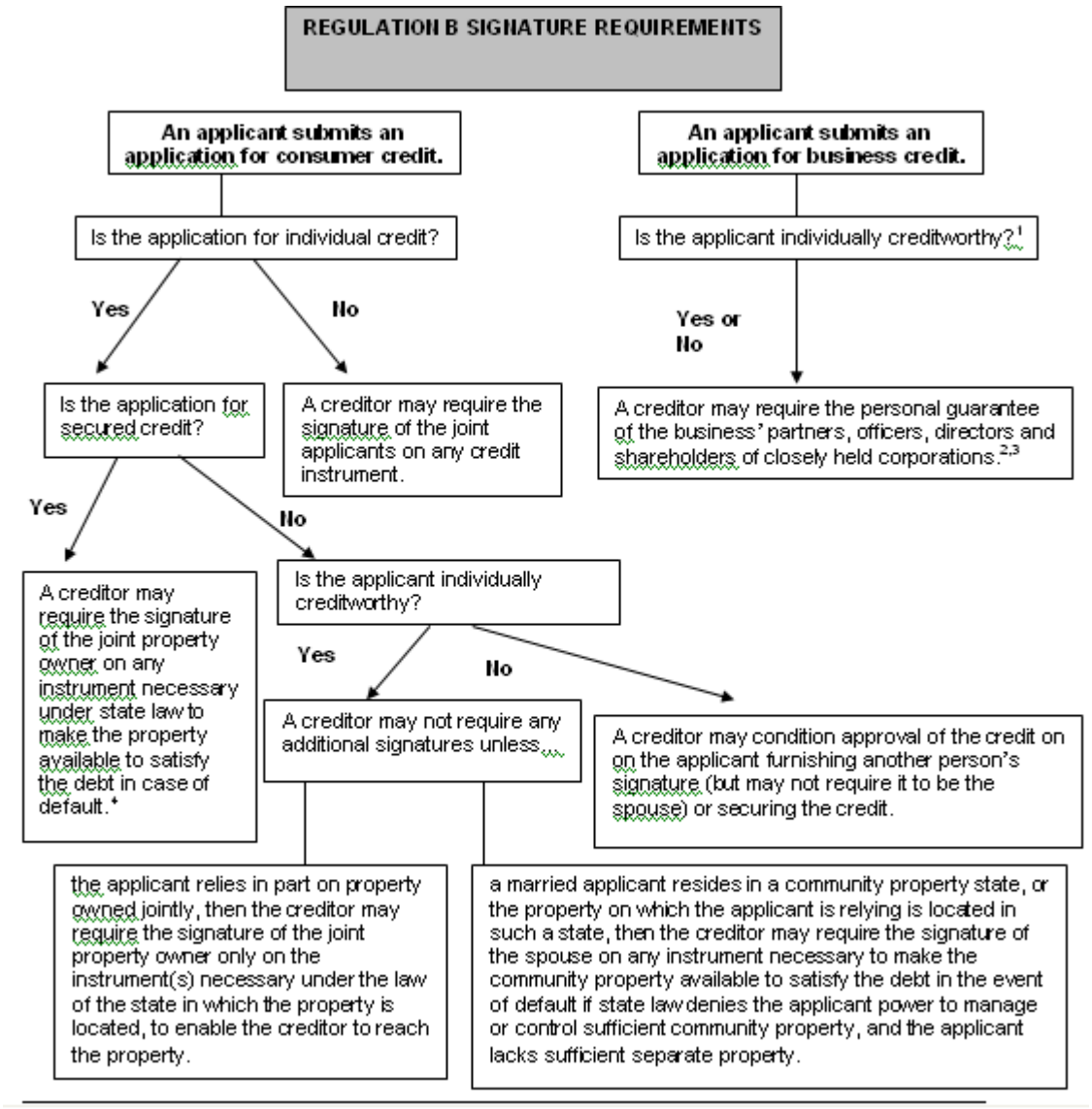
[22]68 Fed. Reg. 13,144, 13,165 (2003) (to be codified at 12 C.F.R. § 202.7(d)(1)).

[23]Official Staff Interpretations at Paragraph 202.7(d)(1), Comment 3, *as amended by* 68 Fed. Reg. 13,144, 13,191 (2003). Model Application Form 1-4, contained in the Appendix to Regulation B, provides for applicants to check an option and initial the application form so as to indicate whether joint credit is sought. *See id.* at 13,172. Official Staff Interpretations at Paragraph 202.7(d)(6), Comment 1.

[24]Official Staff Interpretations at Paragraph 202.7(d)(6), Comment 2.

[25]*Id.* The guarantor is treated as an "applicant" for such purposes. 12 C.F.R. § 202.2(e).

[26]Official Staff Interpretations at Paragraph 202.7(d)(6), Comment 2.



1. If the applicant lacks sufficient separate property, a creditor must value applicant's interest in jointly owned property.

2. The requirement for the guarantee must be based on the guarantor's relationship with the business. A creditor must evaluate the financial circumstances of the partners, etc. before determining if the joint property owner's signature would be required.

3. Follow the chart regarding individual unsecured or secured credit.

4. For example, an instrument to create a valid lien, pass clear title, waive inchoate rights or assign earnings. A creditor may require both property owners to sign the credit and security agreements, if required under state law.