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Spousal Guaranties: When a Franchisee's Spouse Says "I Don't"

The situation is familiar enough to franchisors: a new franchisee is about to execute a franchise agreement, but, rather than sign individually, he creates a new legal entity and agrees, as owner, to guarantee the entity's obligations under the franchise agreement. Everything is going smoothly until the owner's spouse refuses to execute the same guaranty. What now? The purpose of the guaranty is, of course, to protect the franchisor in the event of a default. Is the guaranty worthless without the spouse's signature? How can the franchisor protect itself?

Franchisors should consider two things when a franchisee's spouse says "I don't" - state property laws and the Equal Credit Opportunity Act. The impact of these laws on the franchisor's legal rights, and the franchisor's own risk tolerance, will determine how to proceed. Here are the nuts and bolts.

State Property Laws

State property laws determine whether and to what extent a franchisor can collect against a guarantor's property if the franchisee defaults. When a spouse refuses to sign the guaranty, three key types of state property laws should be considered: community property, equitable distribution, and tenancy by the entirety.

Generally, in community property states, assets acquired and liabilities incurred during the marriage are shared by the spouses, but the application of this general concept varies by state. In some community property states, the spouse's signature is unnecessary because the entire community estate is liable for the debts incurred during the marriage by either spouse. In others, if the spouse refuses to sign, only the signing spouse's separate property and his or her share of the community property will be available to the franchisor. In equitable distribution states, marital property generally cannot be used to satisfy the debt of one spouse. In these states, the spouse's signature is critical, or the franchisor is going to be relegated to the signing spouse's separate property.

Finally, the principle of "tenancy by the entirety" may trump other marital distribution laws in some states. Tenancy by the entirety is a form of joint ownership by a married couple where each spouse owns the entirety of the marital property. Property held in tenancy by the entirety cannot be used to satisfy the debts of only one spouse, making spousal guaranties essential for recovery from marital property held in this manner.

A franchisor's ability to enforce or collect against a guarantor absent a spousal guaranty will vary greatly depending upon which property law applies. Understanding the particular state's laws and how a guarantor's assets are held is critical before deciding to proceed without the spouse's signature.

Equal Credit Opportunity Act

Franchisors who are creditors under the Equal Credit Opportunity Act ("ECOA") must also take care to comply with this law in the context of a spousal guaranty. The ECOA prohibits creditors from discriminating against applicants based on marital status (among other things), and franchisors might be considered creditors in some circumstances. The ECOA does not prohibit requiring spouses to sign as guarantors; rather, it prohibits discrimination by the creditor based on marital status. To comply with the ECOA, franchisors who are subject to it and who require a spousal guaranty must have a distinct, nondiscriminatory basis for doing so - for example, consideration of the enforceability and reach of the guaranty under state property laws.

Conclusion

Bottom line, franchisors must consider state property laws when deciding whether to move forward without a spousal guaranty and the ECOA if they decide to require one.

For more information or to discuss a specific franchise negotiation, please give us a call.

Contacts

Amy Cheng
Fredric A. Cohen
Michael R. Daigle

Contact Information

312-243-1716 or amy.cheng@chengcohen.com
312-243-1717 or fredric.cohen@chengcohen.com
312-957-8366 or michael.daigle@chengcohen.com

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