

Law Watch



A personal guarantee

A guarantee is essentially a promise by one party to another to ensure that a third party fulfils its obligations under an agreement and/or a promise that that party will fulfil those obligations on behalf of the third party should the third party fail to do so. It is a contractual agreement.

Nowadays the most common example of a guarantee is where someone (usually a director) is asked to guarantee the debts of a company. The legal requirements for a guarantee are fairly simple. Under the Statute of Frauds 1677, the agreement must be in writing and signed by the party giving it, i.e. the guarantor. Obviously, this means that verbal guarantees are unenforceable unless they are recorded in writing and signed.



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Guarantee agreements are being increasingly used by companies and banks as a useful means of security in our current uncertain economic climate. Many individuals subject to such agreements will sign them without being aware of the extent of their liability under them. Sometimes, guarantees are incorporated in other documents such as credit account application forms. It is always good advice to read the small print in any agreement but it is especially important to do so if you are being asked to sign any form which includes reference to a personal guarantee. Directors, in particular should beware!

The obligations imposed on a guarantor obviously depend upon the terms set out in it. By understanding what the liability is, a guarantor can make an informed decision about whether they want to take on that responsibility and indeed whether they can afford to. If you supply goods or services to a company, you might also want to consider including personal guarantees before granting credit to your customer. In some ways, a refusal to give a personal guarantee may give you an indication of the confidence the directors of your customer have in their business.

Unfortunately for the guarantor, a guarantee agreement is often drafted to ensure that the guarantor has to guarantee all the borrower's liabilities, whether these were contingent or not and whether they were incurred alone or by the borrower. There is often an express obligation on the guarantor to pay all the expenses arising from any failure of the borrower company to repay the loan and also those arising from the enforcement of the guarantee. This means that the guarantor is liable not just for the principle debt but also for any other borrowing/debts that might have arisen after the guarantee was signed even if that debt included joint borrowings between the debtor and someone else. Interest on the debt and legal costs can also be added to the amount owed.

Also, guarantee agreements will now often state that guarantors have to pay any amount under the guarantee on demand. This means it must be paid straight away, and if it isn't, legal action can be started.

If you are asked to give a guarantee, remember you can seek to negotiate its terms. For instance, you could limit the amount of the guarantee (but watch out for interest and legal costs being added on top of the principle debt) or limit the period of time over which the guarantee is valid. Remember also, that you do not have to give the guarantee but if you refuse the other party may decide not to trade with you.

Guarantees can appear rather harsh on unknowing individuals who sign up to be guarantors because they are of the genuine belief that they are guaranteeing only the principle amount loaned and no more than that. The lesson therefore, is to read these types of guarantee agreement in great detail before putting a signature to it, or alternatively, to instruct a solicitor to read through such agreements first and to advise upon them.



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