The Dangers of Personal Guarantees

This article focuses primarily on the types of personal guarantees sought by banks and other lending institutions in Ireland. Each lender has its own precedent Guarantee; there is no banking industry standard. Entering into a personal guarantee is something that should be done as a last resort in any circumstance. Always obtain independent legal advice.

What is a Personal Guarantee?

A personal guarantee is an agreement whereby the Guarantor agrees to repay the debts of another person (the Debtor) to a lender (the Creditor). Typically the bank will be the Creditor to whom money is owned by the Debtor.

I examine below the some of the dangerous and insidious clauses that such Guarantees typically contain.

Joint and Several Liability

If you are entering into a guarantee with another person, usually referred to as a co-guarantor, usually your liability is joint and several. Joint liability means that you and your co-guarantor are each liable up to the full amount of the guaranteed debt. Therefore, if your co-guarantor died or disappeared or was declared bankrupt, you will remain fully liable for the entire amount of the guaranteed debt. Accordingly, the Lender can pursue you solely, your co-guarantor solely or both of you for the full amount. It would then be a matter for the Guarantor who pays out the full liability to seek reimbursement from the co-guarantor.

Continuing Guarantee

Sometimes a Guarantee will specify a fixed amount but frequently the Guarantee is a “Continuing Guarantee”. This means that even if the current debt, which you are guaranteeing is fully paid off, the Guarantee will continue to exist unless expressly terminated by agreement with the Lender to whom you have given the Guarantee. The default position is that the Guarantee will continue to exist and if the Debtor, subsequently obtains fresh borrowings from the lender, then effectively the Guarantee will continue to exist in respect of those new borrowings. Therefore, it is vitally important that in the event the current debt is paid off that the Debtor notifies you so that you can seek to cancel the Guarantee with the Lender. This should be agreed at the outset with the Lender and the Debtor. In my experience, the Lender will not notify you that the debt has been repaid, as they will wish to have the comfort of having a Continuing Guarantee forever over the future liabilities of the Debtor.

Lender’s Right of Set Off

Such a clause allows the lender a right of set off in respect of any account you may have with the Lender that is in credit. Typically such right of set off can occur without the lender being obliged to notify you. The effect of this is that the lender can demand the repayment of the full amount of the Guarantee at any time and then without notice to you can forfeit any monies held to your credit at the Lender towards full or part payment of your obligations to the lender as Guarantor. It would, therefore, seem practical that if you have monies held to your credit in that Lender, that you would be as well off to place those funds with another financial institution in order to avoid the dangers of appropriation of any credit balances in discharge of your obligations under the Guarantee.

Indemnity
Most bank Guarantees are not only a Guarantee, but they is also an Indemnity. This is significant both in legal and practical terms. An Indemnity is an agreement by the Guarantor (Indemnifier) to pay the amount set out in the “Guarantee”, regardless of whether the bank has demanded payment from the Debtor. In effect, this means that the Lender does not have to bother to pursue the Debtor at all for the debt and can just decide at any time to seek repayment of the full amount of the guaranteed debt from you.

The second implication of the Indemnity which is of particular legal significance is that it is a contractual agreement by you to pay a fixed amount of money that stands separate and apart from the underlying loan agreement between the Debtor and the Lender. Therefore, if the underlying loan agreement between the Debtor and the Lender was legally unenforceable for whatever reason (i.e. the Lender couldn’t legally enforce the debt against the Debtor), the Guarantee you have executed, because it is also an Indemnity, will still be enforceable against you in any event. This allows the Lender to recover the debt from you even if it’s not legally entitled to recover it from the Debtor. This is an extraordinary and unfair outcome.

**Debt Compromise**

This type of clause provides that the Lender can reach various types of arrangements with the Debtor to compromise (reduce) the debt owed, but the Lender is still entitled to pursue you as Guarantor for the full outstanding debt. Therefore, a Debtor might believe that he had reached a compromise with the Lender who has agreed, for instance, to write off a portion of the debt, but the Lender can still look to you as Guarantor for the portion of the debt that they have written off.

**Crystallisation of Debt**

Such a clause sets out that if the Guarantee ceases to be a Continuing Guarantee, the Lender can effectively crystallise the debt of the Debtor at a point in time and by crystallising the amount due under the Guarantee, the Lender can demand that any further dealings between the Debtor and the Lender shall be done through a separate banking facilities and accounts. The effect of this is that subsequent payments to the Lender by the Debtor under the new facility would have no effect on reducing the amount of the debt that you have guaranteed under the original facility.

**Contingent Liabilities**

It is worth highlighting this type of clause as it provides that the amount of the guaranteed debt includes contingent liabilities of the debtor. Therefore, if the Debtor has some small outstanding liability to the Lender, but a significant contingent liability to it under, for instance, a bond or guarantee or some other contingent liability arrangement, then the total debt that you have guaranteed is the full amount of both the actual and contingent liability. The Lender, therefore, reserves to itself the ability to pursue you for both the actual debt and the contingent debt in your capacity as Guarantor.

**Property Lien**

This insidious clause provides that the Lender shall have a lien on all the Guarantor’s property held by the Lender, this would, of course, cover any title documents held by the Lender on your behalf. It also covers situations where there is a right to set off bank accounts which I have covered earlier in this article.

**Death of Guarantor**
A Guarantee survives your death and continues to be a contingent liability of your Estate until such time as it is released. There is no obligation on the Lender to release your Estate from this liability and typically the Lender will only do so in the event that a new Guarantor can be found to step into the deceased Guarantor’s shoes.

Conclusion

Not all guarantees contain all of the above clauses; nevertheless always obtain independent legal advice before giving a personal guarantee. Even better, avoid giving one in the first place if at all possible. Taking legal advice provides you with an opportunity to understand fully your commitments and perhaps to limit your liability through negotiation with the bank by your solicitor. At the very least always insist on an agreement with the Lender as to when your responsibility under the Guarantee will cease.

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