

## The Personal Guarantee Dilemma: Should a Director Succumb to a Personal Guarantee?

There are two fundamental principles in company law. First, every company has its own legal personality, meaning that it has its own legal identity, which is not the same as the identities of its shareholders and directors. Secondly, in the case of limited companies, which make up the vast majority of companies in England, the liability of shareholders is limited: shareholders are liable to pay for their shares, but they are not liable for the company's debts. Sometimes, however, directors, developers and employers looking to finance a construction project are being asked by their lender to give a personal guarantee. The question remains, should directors give a personal guarantee? What are the implications?

### What is a personal guarantee?

A personal guarantee (also called an individual guarantee) is a promise, given by an individual (the director), to ensure that a third party (the company) fulfils its obligations or, if the third party fails to do so, that the individual will fulfil those obligations. It is a contractual agreement that creates a secondary obligation to support a primary obligation of one party to another. Personal guarantees may take the form of a stand-alone agreement or a simple contract provision. The primary obligation may be to repay a loan made by a lender to a borrower. The guarantor promises the lender that the borrower will perform its obligations and, if it does not do so for any reason, the guarantor will perform them on its behalf.

The personal guarantee essentially acts as security for company borrowing and is a way to pierce the so called 'corporate veil'. The bank's standard form guarantee will be drawn to give the bank maximum protection: technically, it will be both a guarantee and an indemnity. An indemnity, like a guarantee, is a promise to be responsible for another's loss. Unlike a guarantee, it is a primary obligation given by the indemnifier to the person to be indemnified. By framing it as an indemnity the bank makes the director liable even if there is a problem with the underlying loan. In practice the bank is very unlikely

to look to the director to pay unless the company has defaulted on the loan and enforcement has been

unsuccessful. Strictly, though, it could make a claim at any time.

### Things to consider



There are many things to consider before giving a personal guarantee to secure your company's borrowings. Firstly, you should ensure that there is a monetary limit on the guarantee obligation. That way you will need to sign a new personal guarantee if a new company loan is to be taken. Without a cap you could find yourself personally liable for increased borrowings without appreciating that you are increasing your personal liability. You could also be liable for new borrowings taken by the company after you have ceased to be a director.

**Secondly**, you should consider linking the guarantee to a specific loan. This is a good way to avoid ever increasing personal liability as company borrowings increase.

**Thirdly**, you should avoid securing the loan by a legal charge over your house. If you do agree to give such security, the co-owner of the house (such as a spouse or partner) will also need to agree to give the security. Such a security will put your house (and your equity portion held by both co-owners) at risk.

**Finally**, you should also consider your duties owed as a director. The guarantee will place a director in a situation where his interests may conflict with those of the company, meaning he will need to declare his interest in the relevant transaction to the other directors, and may be prohibited from voting under the company's articles of association. This situation should be approved by an ordinary resolution of the shareholders or by the other directors.

### Conclusion

It is understandable that a director's main goal is to progress his business, and ensuring finance is available by securing a loan facilitates this. Nevertheless, a director should always consider what the implications of signing such a guarantee entail and weigh up the options carefully. In any case, a director should seek legal advice when being asked to commit to a personal guarantee.

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