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BARRISTERS AND SOLICITORS

Personal Guarantees (or “Guaranteed Personal Exposure”)

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In some schoolyards a handshake is still sufficient to seal a deal, but in most commercial contract settings the days of being able to rely upon the phrase, “my word is my bond”, are gone. Especially in today’s economic climate, banks and other contracting parties want solid assurances that you will fulfill your end of the bargain.

If you own a corporation, chances are that you took the step of getting corporate status so that you could protect your personal assets (i.e. your house, vehicles, bank accounts and investments) from the claims of creditors who deal with your business. From a contract perspective, this intention “goes out the window” if you are required to sign an agreement as a personal guarantor or indemnifier. In this situation, you are bound to the provisions of the agreement equally with your company; and if there is default under the terms of the agreement the non-offending party may force you personally to pay damages or to remedy the breach.

Consider, for example, a bank loan agreement. If your business requests a loan or line of credit from a lender, that lender will review the assets of the corporation which can be pledged as security for repayment of the debt. The lender may insist that the owners of the company sign personal guarantees to ensure that the lender has someone to pursue if the company has insufficient assets to satisfy the claim at the time of default. Until recently, principals of well-established businesses were not typically asked for personal guarantees; and if they were required, there was rarely a need for enforcement of those guarantees. However, the North American financial market has caused the banking industry to make some major shifts in their lending and security policies.

Personal guarantees have become commonplace and are often key to a bank’s commitment to lend funds. Moreover, the shareholders who provide these personal guarantees are frequently required to pledge their own assets as collateral security for the guarantees. Personal property security searches and real property searches will reveal the registration of these types of liens against business owners.

Note also that if a personal guarantee is given by someone who does not have a direct ownership in the business, then the requirement for independent legal advice is a near certainty. Care must also be taken to ensure that when the debt is repaid in full, a complete release is provided by the lender, along with a discharge of any related security interests.

Although personal guarantees expose your hard-earned assets to the claims of others, they are often unavoidable if you want to obtain a loan or enter into a contract. The best you might be able to do is to negotiate an upper limit on the dollar value of the guarantee and/or limit the enforcement period of the guarantee. As always, you should seek legal advice prior to signing any indemnities or guarantees.

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