

TAILOR YOUR GUARANTEE

This paper encourages you to negotiate the terms of a guarantee you intend to give and suggests issues you might address.

A guarantee is a contract by which a person (the **guarantor**) becomes liable to another person (the **creditor**) on account of a liability of a third person (the **debtor**) to the creditor.

The debtor remains primarily responsible to the creditor for the liability, but the creditor can now have recourse to the guarantor. If there are two or more guarantors, any of them in fact discharging the debtor's liability can claim a fair contribution from the other guarantors. Any guarantor who contributes to the discharge of the debtor's liability can claim reimbursement from the debtor.

There is no standard form for a guarantee. It is just a contract, and like other contracts can be the subject of a negotiation about its terms. A significant body of law exists to protect a guarantor from unfair situations, however many of the rules can be overridden by the particular contract itself and lawyers acting for creditors will attempt to do so. Providers of finance usually have their preferred form of guarantee, which naturally favours the provider (as creditor), and they hope a guarantor will agree to their form without change. But you can ask for a change.

Time Limit: You can agree that for a claim by the creditor against the guarantor to be effective, the claim must be made before a specified date. This is much better than an open-ended guarantee. Some industry forms only permit the guarantor to terminate if the creditor is then paid out in full (by the debtor or the guarantor), or to terminate only on say 6 months' notice. Avoid these.

Limited recourse to a monetary limit: You can specify the maximum amount the guarantor will be liable to pay the creditor. However, be alert to drafting that in effect specifies a maximum amount + interest + costs (a common drafting technique), because interest (particularly at "default interest" rates as might be charged by the creditor against the delinquent debtor) and the creditor's costs of enforcement against the delinquent debtor can be significant amounts in their own right. It is much better to specify a maximum amount, full stop.

Limited recourse to an asset: Sometimes parties agree that the guarantor's maximum liability to the creditor is an amount equal to the future net sale proceeds of some asset, usually real estate and often a family home. Thus, if the creditor makes a demand against the guarantor, the real estate is sold and the net sale proceeds passed on to the creditor in full discharge of the guarantor's liability. At the start the creditor takes a mortgage over the real estate, to secure future payment.

Last resort: Agree that the creditor must effectively exhaust its remedies against the debtor (and any security the debtor granted), before the creditor can claim against the guarantor. You might agree that, at a minimum:

- the debtor, if a company, be placed in administration, receivership or liquidation
- the debtor, if an individual, be made bankrupt or at least have a court judgment for the liability awarded against him or her
- any real estate security granted by the debtor be sold.

Information: As a matter of law, the creditor is bound to keep confidential its knowledge of and dealings with the debtor, so you cannot expect the creditor to volunteer information to the guarantor before signing of the guarantee or during its operation. However, the debtor can consent to disclosures. So, with the debtor's consent, the guarantor might require:

- before signing the guarantee, full details of any credit history known to the creditor and full details of the financial accommodation (loans, leasing etc) the creditor proposes to extend to the debtor
- periodic disclosure of the debtor's accounts with the creditor (copies of monthly statements etc)
- prompt notification of any default by the debtor that the creditor becomes aware of
- a material change in the arrangements between the creditor and the debtor effectively releases the guarantor, unless the guarantor consented to the change.

A joint publication of Adam Gamble (partner) (mobile 0439 384 298; agamble@crawfordlegal.com.au) and Mark Sallis (barrister) (mobile 0438 834 430; msallis@senet.com.au).