Have you been asked to provide your Guarantee?

Many of us are asked by, or even offer a family member to provide a guarantee and perhaps security, to a lender so that the family member can buy that first car, or to overcome a shortfall in deposit when buying a first home. For others who operate companies, they may be required to provide their guarantee so that the company can lease equipment, rent premises, establish credit accounts with suppliers, or operate an overdraft.

It is important that anyone who is asked to provide a guarantee understands precisely what their liabilities are under the arrangements. Usually when someone is asked to provide their guarantee, they are also asked to provide an indemnity.

What is a guarantee?

A guarantee is a contractual promise by the Guarantor, to another party (eg. lender, landlord, supplier), to fulfil the obligations by a third party (eg borrower, tenant, the company), in case that the third party fails to fulfil their obligation.

For the purpose of the discussions that follow, we will assume a guarantee is being given to a lender for the loan debt of a borrower to the lender. The same principles apply if the guarantee is being given to a landlord for a tenant or to a supplier for a customer.

The Borrower has the primary liability for the obligations guaranteed by the Guarantor. The Guarantor has a secondary liability which is only triggered when the Borrower fails to perform the obligations that have been guaranteed. The Guarantor's liability cannot be greater than the liability of the Borrower.

Despite the fact that a Guarantor's liability is secondary in nature, the Lender is not required to first pursue the Borrower, or enforce any other security, before claiming against the Guarantor.

What should you know before giving your guarantee?

If you are to give your guarantee, you should, ascertain;

- the financial capacity of the Borrower to meet their obligations;
- if your guarantee is specific so that it applies only to a particular transaction, or if it is a continuing guarantee in respect to a series of transactions to be entered into between the Borrower and the Lender;
- if your guarantee is limited to a specific amount, or it is unlimited so as to catch all possible amounts which may be owing or unpaid by the Borrower to the Lender;

- is your guarantee unsecured or secured? If it is secured, for example by a mortgage over a property owned by you, if you fail to pay when demand is made of you by the Lender, this creates a default of the security over your property and entitles the Lender to sell your property. If your guarantee is unsecured, if you fail to make payment, the Lender will need to sue you in Court to recover payment.

What rights does the Guarantor have if he makes payment?

If the Guarantor makes payment to the Lender after default by the Borrower, and after demand to pay from the Lender:

- The Guarantor has the right to recover the payment from the Borrower. Whilst this is not likely to be worthwhile at the time the Guarantor makes payment, the Guarantor has a period of 6 years in which to take recovery action.
- If other persons are Co-Guarantors, the Guarantor making payment can claim contribution from the Co-Guarantors.
- The Lender is bound to give the Guarantor making payment all its remedies against the Borrower. This includes any security held over the Borrower's assets or if the Borrower becomes bankrupt or insolvent, any dividend or distribution that the Lender is to recover from the bankruptcy or liquidation.

When is the Guarantee discharged?

Your guarantee is not usually discharged or released until the Lender has received payment in full of the guaranteed obligations, or until the Lender provides to you a specific release. If you die, your estate usually remains bound by your guarantee. However, other circumstances may result in your guarantee being discharged or being unenforceable such as;

- If the obligations of the Borrower become void, the guarantee falls away.
- If a variation to the underlying contract which is not for the Guarantor's benefit is made
- If the Lender gives the Borrower more time to meet its obligations thereby removing the ability of the Guarantor to crystallise the contingent obligation under the guarantee, and make a claim against the Borrower
- The Borrower is released from the primary obligations.
- Where the guarantee is joint or, joint and several with co-guarantors and a co-guarantor are released.
- If the Lender releases or impairs any security it holds for the same debt as is guaranteed.
- If the guarantee was provided as a result of undue influence from someone, or there has been non-disclosure or misrepresentation by the Lender to persuade you to give the guarantee.

Indemnity

Because a guarantee may become enforceable, as shown above, it is usual for the Lender when taking your guarantee to also require your indemnity. An indemnity is an obligation on your part to make good the loss of the Lender. Unlike a guarantee which is a secondary liability, an indemnity is a primary liability. It is not dependent of the existence of the underlying debt or the default by the Borrower. It follows the indemnity can be relied on by the Lender when the guaranteed obligation, or the guarantee, become unenforceable.

Conclusion

Giving a guarantee and indemnity or both is a serious and a complex thing to do. The moral of the story is to make sure you understand your rights and obligations before your give your guarantee and indemnity. If you, or someone you know, wants more information or needs help or advice regarding a guarantee, please contact Michael Battersby or John Bateman on 02 4731 5899 or email us at enquiries@batemanbattersby.com.au.