

GUARANTEES & RESULTING OBLIGATIONS

Many commercial contracts require a person, such as a company director, to sign as a “guarantor” to a third person’s, or company’s, obligations.

The obligations surrounding the law of guarantees arise from the common law and statute. Prior to signing, it is important to understand the personal obligations which may arise as a result of signing as a guarantor of another’s obligations.

What is a Guarantee?

A guarantee is a promise by a person to answer for the non-performance of a third party’s obligations. It is a *personal* contractual obligation and arises if:

1. there is an obligation by a third party; and
2. the guarantor and the creditor *intend* to secure the performance of that obligation.

Nature & Extent of Liability

Actual liability under a Guarantee Agreement will arise when the debtor defaults under the Agreement, dependant upon two factors; the terms of the Guarantee itself and the nature of the obligation guaranteed.

The extent of the Guarantor’s liability may be:

- Specific: where the agreement applies to a specific liability or a specific amount; or
- Continuing: where the agreement covers liabilities which may arise from time to time.

Because the guarantee allows the creditor to recover from the debtor and/or the guarantors, the creditor has a choice of suing the creditor, the guarantor, or the creditor and guarantor jointly.

The creditor need not seek recovery from the creditor in the first instance and may proceed directly against the guarantor.

Directors’ Guarantees & Directors’ Liabilities

Where a Company enters into a contract with another, the directors of that Company will not usually be liable for the company’s default, even where the directors sign the contract on the company’s behalf. There are exceptions, one being where the company incurs a liability after it is insolvent (i.e. engages in insolvent trading).

However, a Director can be liable where they assume a *personal liability* by providing a guarantee to the third party for performance of the company’s obligations. For such a guarantee to have effect, the Director must sign *separately* as a Guarantor.

Two or more Guarantors

Where a guarantee contains an express or implied term that more than one guarantor will sign it, then a single guarantor will not be

liable if the intended co-guarantor fails to sign it or to sign validly (*Marston -v- Charles H Griffith & Co Pty Ltd* (1985) 3 NSWLR 294).

However, each case will depend upon the circumstances surrounding the guarantee document and the signing of it, otherwise referred to as the “objective matrix of facts”.

The intentions of a person signing as Guarantor are crucial as to whether a Guarantee will be enforceable. For example, where a document requires that all Directors of a Company provide a Guarantee, and only one Director signs with the intention of providing a sole Guarantee, such a Guarantee may be enforceable (*Prosilis -v- Double Bay Newspapers Pty Ltd* [2000] NSWCA 30).

However, adopting the above example, where one Director signs with the intention that the other Directors sign, but those signatures are not obtained, then the Guarantee will not be enforceable against the Director who did sign (*Prosilis -v- Double Bay Newspapers Pty Ltd*).

Possible Statutory Defences to Guarantees

A person purported to be made liable pursuant to a Guarantee may have recourse to the following statutory defences, if applicable:

1. Unjust Contracts
Pursuant to s 7 of the *Contracts Review Act 1980* (NSW) it may be argued that a provision in a Guarantee agreement is unjust in the circumstances. For example, it could be argued that where the Guarantor could not read or speak English, and did not obtain adequate legal

advice, the Guarantee agreement was unjust in those circumstances.

2. Misleading or Deceptive Conduct
Pursuant to s 53 of the *Trade Practices Act 1974* (Cth) a company must not make a false or misleading representation regarding a guarantee, amongst other things.
For example, where a creditor company obtains a guarantee by stating to the Guarantor that the guarantee relates to a liability of up to \$20,000.00, where in fact it relates to unlimited liability, the Guarantee may be reviewed pursuant to the Act.

3. Corporations Law

Pursuant to s 440J of the *Corporations Act 2001* (Cth), where a director has guaranteed a Company's debts, and where the Company is under external administration, a creditor may not proceed against the Director for the company's debts.

Case studies

1. Jane agrees to lease premises to Company Pty Ltd, a sole director company. The Lease purports to make directors of the company guarantors to the company's obligations of the Lease. Mr Director, as sole director of Company Pty Ltd, signs the Lease as "Lessor", on behalf of Company Pty Ltd. Company Pty Ltd then becomes insolvent and falls in rent arrears.
Jane is unable to proceed against Director A, as although he signed the Lease on

behalf of Company Pty Ltd, he did not sign the Lease personally as Guarantor.

2. ABC Pty Ltd agrees to provide services to 123 Pty Ltd. The Service Agreement provides that in the case of companies, all directors must provide their signatures as Guarantors of the company's obligations. 123 Pty Ltd duly executes the Service Agreement, along with Director A as guarantor. Director A provides the signed Agreement to Director B for signing. Director B never signs and 123 Pty Ltd subsequently becomes insolvent.

ABC Pty Ltd sues Director A for 123 Pty Ltd's outstanding debts. At the Court hearing, Director A successfully defends the claim, as Director B never signed the Service Agreement in circumstances where the Agreement and Director A clearly intended for all directors to provide a guarantee to ABC Pty Ltd.

3. AAA Pty Ltd agrees to provide services to Family Pty Ltd, a husband and wife company. The Service Agreement provides for all directors of a contracting company to sign as guarantors. The husband signs the Service Agreement as Guarantor but does not provide the Agreement to his wife for signing. Instead, he forwards the signed Agreement to AAA Pty Ltd and AAA Pty Ltd commences providing services to Family Pty Ltd. Family Pty Ltd fails to pay its debts and AAA Pty Ltd sues the husband.

The husband is liable as guarantor for Family Pty Ltd's debts as he was aware of the term for all directors to sign the Guarantee and through his conduct,

intended to be the sole guarantor of the Agreement.

For further information please don't hesitate to contact

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