

Liability under a Personal Guarantee

As featured in The Sunday Business Post, 28 June 2009

The most important thing to realise about guarantees is that when it comes to payment, the liability of the guarantor will include the unpaid principal and the interest which continues to accrue at a compound rate of interest.

Compounding of interest means that interest is added to principal annually and interest continues to accrue on the sum of both. Over time, the result of compounding of interest means that the amount of interest owing may well exceed by several times the original amount of the loan.

The longer the loan remains unpaid, the greater the effect of compounding and the greater the liability of the guarantor, which continues to grow at a compound rate until discharged.

It is usual for banks lending to developer borrowers to request personal guarantees from the personal owners of the development company borrower.

This practice is widespread and is regarded as “additional security” for the loan and has several attractions to lending banks. Firstly, the personal guarantor becomes a mark for repayment of the loan. Secondly, it ties the guarantor into personally managing the affairs of the borrower so as to limit his credit exposure to the Bank. And, thirdly, it helps to secure the Bank’s ability to trace realised profits from the underlying commercial transaction in the hands of the personal guarantor.

The value of a personal guarantee is directly related to the net worth of the individual who has agreed to give the guarantee and so the law requires particular formalities to be observed by the person giving a guarantee so as to impress the personal nature of the obligation incurred by providing a guarantee.

ENFORCEMENT OF A JUDGMENT

To recover monies owing under a guarantee by the guarantor, a bank must first obtain judgment from the guarantor. It can often be the case that on securing judgment, it is discovered that the judgment debtor/guarantor has no available assets under his control against which the judgment debts may be enforced.

There are a number of enforcement procedures open to banks and the available options include:

1. Registration of a judgment: The bank can register the judgment in the High Court. Upon registration, it will generally be listed in any judgment search which is carried out against the individual and recorded in such publications as the *Experian Gazette*.
2. Seizure by the sheriff: Upon lodging the appropriate documentation in the High Court and forwarding it to the county sheriff, the bank can direct the county sheriff to attend at the debtor's premises and seize the debtor's goods. The sheriff will then sell the goods and pay the proceeds to the bank, less the expenses of the execution.
3. Attachment of debts/garnishee order: This procedure enables the bank to recover monies which are owing by third parties directly to the judgment debtor. Such third parties could include a trade creditor or a solicitor holding funds on behalf of the judgment debtor.
4. Judgement mortgage: This enables a judgment creditor (such as a bank) to register a mortgage against the judgment debtor's land. Obviously if there are other previous charges/mortgages on the land, these will take priority to this judgment mortgage.
5. Instalment order: The court may order the debtor to pay the debt either in one payment or by instalments. If the debtor has not paid the instalments as they fall due, the creditor can issue a summons for the arrest and imprisonment of the debtor.
6. Bankruptcy: If an act of bankruptcy occurs (i.e. if the debtor fails to pay the sum referred to in the bankruptcy summons or if a return of no goods has been made by the county sheriff), the bank can issue a bankruptcy petition seeking to declare the individual a bankrupt.

FINANCIAL REGULATOR'S CODE OF CONDUCT

In February 2009, the Financial Regulator issued two mandatory Codes of Conduct which limit the freedom which lenders have enforce personal guarantees over personal private residences: the *Code of Conduct for Business Lending to Small and Medium Enterprises* and the *Code of Conduct on Mortgage Arrears*.

The Code dealing with Business Lending to Small and Medium Enterprises provides that any enforcement of a personal guarantee over a principal private residence must be in accordance with the Code of Conduct on Mortgage Arrears.

The most significant provision of the Code of Conduct on Mortgage Arrears requires lenders to wait at least six months from the time arrears arise, before taking repossession proceedings.

The Code of Conduct on Mortgage Arrears further provides that lenders must not seek repossession of property until every reasonable effort has been made to agree an alternative repayment schedule with the borrower or his/her nominated representative. Given that many loans to property developers would have employed complex corporate structures, the requirement that every reasonable effort is taken to agree an alternative repayment schedule may in practice lead to significant time delays.

IMPACT OF THE NATIONAL ASSET MANAGEMENT AGENCY (NAMA)

We think that there are good reasons to believe that NAMA may well adopt a different approach to recovery under personal guarantees.

Experience of other bad-bank regimes such as the Resolution Trust Corporation in the US during the early 90's indicates that the RTC attributed a zero value across the board to personal guarantees in connection with defaulted loans; while at the same time made release of obligations under personal guarantees conditional on compliant conduct by individual developers.

We are not suggesting that NAMA is bound to follow the approach used in other cases. However, we are recommending to clients to endeavour to stay in the game until the next round when NAMA is up and running.



For more information please contact:

Jill Callanan
T: +353 1 6371551
E: jcallanan@lkshields.ie

About LK Shields Solicitors

LK Shields Solicitors is one of the leading law firms in Ireland. Founded in 1988, today we number some 24 Partners, 70+ fee earners and 130 staff. Our principal areas of practice include corporate, litigation and dispute resolution, commercial property, intellectual property, financial services, employment, pensions and employee benefits.

39/40 Upper Mount Street, Dublin 2 | T: +353 1 6610866
W: www.lkshields.ie

Copyright

If you would like to reproduce any of this publication please contact Nicola McNamara on +353 1 6385882

© LK Shields Solicitors, July 2009. All rights reserved.

The material in this publication is for general information purposes only. Professional legal advice should always be sought in relation to any specific matter. No liability will be accepted for any losses incurred by those relying solely on this publication.