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Enforcing Against a Personal Guarantor



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Introduction

The purpose of this briefing paper is to provide an overview of the process where a lender wishes to enforce a personal guarantee against an individual personal guarantor (a "Personal Guarantor") in respect of monies due from a borrower or principal to a lender (classically under a facility agreement).

This briefing paper will briefly cover the following areas:

- Basic concepts relevant to a contract of guarantee.
- Key issues for a lender to be aware of in making a demand for payment against the principal and the Personal Guarantor.
- Obtaining a judgment following a demand for payment where the demand has gone unpaid by the Personal Guarantor.
- Enforcing this judgment against the Personal Guarantor.

Basic Concepts relevant to the Contract of Guarantee

In simple terms, a personal guarantee is a guarantee under which an individual agrees to be responsible for the financial obligations of a borrower or debtor to a lender, in the event that the borrower or debtor fails to pay an amount owing to the Lender.

The following are some key general points to remember about personal guarantees:

- A personal guarantee creates a secondary obligation (usually a payment obligation) to support a primary obligation between the lender and the borrower;
- A Personal Guarantor's obligation is contingent on the borrower's primary obligation, hence if the borrower is not liable to repay the lender then the Personal Guarantor should not be liable either;
- A guarantee is different from an indemnity which is also a promise to be responsible for another's loss. However, an indemnity is a primary obligation which is not contingent on the obligations of the borrower. This means that, if the underlying transaction is set aside for any reason, unlike the guarantee, the indemnity should remain valid;
- As a basic premise a guarantee (as opposed to indemnity) is unenforceable unless it is made or evidenced in writing and signed by the Personal Guarantor; and
- A distinction should be made between a guarantee which is supported by security from the Personal Guarantor, for example a charge over real property, and one which is not. Where a guarantee is supported by security the lender is a secured creditor and, following the making of a demand under the guarantee, the lender could seek to enforce its security pursuant to the terms of the relevant security document. Security here could include the Personal Guarantor having cash with the lender which would probably be the subject of a collateral agreement or in any event set-off rights. Where a guarantee is unsupported, following a demand which is unpaid, the lender will seek to obtain a judgment against the Personal Guarantor and/or possibly petition for bankruptcy of the Personal Guarantor.

Making a Demand against a Personal Guarantor

Introduction - making a demand against the principal

Depending on the terms of the loan made available to a borrower, the facility may be repayable on demand by the lender or upon the occurrence of an event of default in accordance with the terms of the facility agreement.

Some general principles to be aware of when making a demand are:

- The demand must be made by the lender strictly in accordance with the express terms relating to making demands and serving notices which are contained in the facility agreement.
- Where facilities are stated to be repayable on demand the lender should be able to demand repayment of all or any part of the facility in question at any time during the life of the loan, without having to point to any particular default on the part of the principal. Before making a demand in these circumstances the lender should confirm that there are no other documents or agreements (written or oral) or dealings between the lender and the principal which could prejudice the lender's ability to call a demand at any time without having to give a reason. For example have representations been made to the borrower that the facility will not be demanded in the absence of default?

Usually, a loan agreement in respect of a term or other committed facility will provide that on or after the occurrence of a specific event of default the lender may either demand immediate repayment of the facility or may make the facility repayable on demand.

Before making such demand under a committed facility the Lender should check that:

- At least one event of default has occurred, so that the lender is in a position to make a demand on the borrower (and later on the Personal Guarantor);
- All remedy periods (if any) relating to the event of default in question have expired and that the default in question has not been remedied during such period; and
- It has not, either explicitly or by its actions, waived the default in question. If the lender has been aware of a default and has permitted the default to continue unchecked, it may be difficult for the lender to rely on the default in making a subsequent demand.

Service of a demand

- The wording dealing with the method of service of any notice in the facility agreement should be followed exactly. The relevant document will frequently provide for notices to be sent by fax or by letter or by hand and may specify an exact address at which the demand is to be served. The lender may need to use the services of a process server. Note that, in some countries, service of demands can only be made by a

judicially appointed agent.

- The facility agreement may specify when delivery is deemed to be made and this will usually depend on the mode of service employed. It is important to know when delivery will be deemed to be made or will actually be made, as the lender will not be in a position to take any further action until after deemed or actual delivery of the demand.

Obligation to serve a demand on a borrower before serving a demand on the Personal Guarantor

Usually, a guarantee will include a provision that the lender need not make any demand upon the borrower or principal before demanding on the Personal Guarantor. However, a lender would typically demand on the borrower or principal first and give them an opportunity to repay before demanding on the Personal Guarantor, and it is good practice to do so. It should be noted that if there is any evidence of collusion between the principal and the lender, or dealings between them which might prejudice the Personal Guarantor's position, then the Personal Guarantor may attempt to seek an order restraining the enforcement of the personal guarantee.

Delay before serving a demand on the Personal Guarantor

The question often arises as to how much time a borrower must be allowed after the making of a demand to make payment before the lender can take further steps. The position is that action can be taken reasonably quickly after a demand (e.g. two hours during which banks are open in the jurisdiction of the Borrower i.e. absent other arrangements a lender only has to give the Borrower time to go to his bank and withdraw the money before enforcement). Each case however will need to be assessed on its own merits. In all cases, specific advice should be sought on this point.

If the Personal Guarantor has provided a full guarantee and indemnity for the indebtedness of the borrower and the guarantee in its terms absolves the lender from having to demand on the borrower before demanding on the Personal Guarantor, the lender could serve a demand on the Personal Guarantor at the same time as the lender serves the demand on the borrower. In certain circumstances, for example where a lender is concerned that the Personal Guarantor may withdraw a credit balance from an account, the lender may wish to make demand on the Personal Guarantor moments after making demand on the borrower and then execute its right of set-off.

Demanding a part of the debt

If a lender wishes to demand (either from the borrower or the Personal Guarantor) part only of the debt owed by the borrower, the lender must be careful to preserve its right to demand the balance at any time or times in the future.

The loan documents should be checked carefully to ensure that the lender is entitled to demand part (as opposed to the entire amount) of the debt owing. The lender would need to be clear that the remainder of the indebtedness owing is not waived and may be demanded and pursued at any time in the future. This

should be dealt with at the time the demand is made, to minimise the risk that the initial act of attempted recovery might preclude further acts of recovery for the remainder of the debt. Defaults should be acknowledged as they arise, with the lender promptly notifying the borrower and any of the Personal Guarantors in writing of the defaults and reserving its rights and making it clear in any demand letter that the lender is entitled to demand the full amount of the debt but at this stage chooses to demand a certain lesser sum, strictly without prejudice to the lender's right to demand the full amount or any part of it and/or to take any enforcement steps its wishes at any time or times in the future.

Making Demand on the Personal Guarantor

Similar considerations to those applicable to making a demand on a principal as set out above will also apply to a demand made on a Personal Guarantor.

Reviewing the Personal Guarantee before service of demand for payment under the Personal Guarantee

Before a lender proceeds to serve a demand for payment on the Personal Guarantor, it is important to review the terms of the guarantee so as to identify any weaknesses in the guarantee which may make recovery in accordance with the terms of the guarantee problematic. The following touch on some of the key points to review:

Execution

The guarantee should be checked to ensure it has been duly executed by the Personal Guarantor and if, as is usual, it is in the form of a deed, that this was done in the presence of a witness who attests the signature of the Personal Guarantor.

Amount guaranteed

It is important to identify clearly the extent of the obligations of the borrower which the Personal Guarantor has agreed to guarantee. In addition, where a guarantee is to be relied upon at a later stage to secure a new facility or further advances not contemplated by the original facility, any facility agreement issued after the date of the personal guarantee should refer to the personal guarantee and the Personal Guarantor should be required to confirm that the guarantee covers such new or further amounts. This can be effected by the Personal Guarantor:

- Signing the facility agreement evidencing the further advances, if it contains an appropriate statement confirming that it is covered by the guarantee; or
- Signing a letter of confirmation confirming the all-monies nature of the existing guarantee and that it can be relied on for the further advances and in either case obtaining independent advice in the case of a situation which could give rise to a presumption of undue influence.

Indemnity

The terms of the guarantee should be reviewed to determine

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whether it includes both a guarantee and an indemnity and a provision that the liability of the Personal Guarantor is as sole and primary obligor and not merely as surety. Express indemnity wording is included to ensure that the Personal Guarantor has primary as well as secondary liability to the lender. If the guarantee does not contain indemnity wording or sole and primary obligor wording – and even the latter may not be sufficient on its own – it could mean that the lender cannot enforce the guarantee in a number of circumstances, for example where the obligation which is guaranteed changes, or there has been a variation by an increase in the facilities advanced to the principal, unless the guarantee provides otherwise, as mentioned below.

Indulgence/Waiver of Defences

There are many circumstances where, by virtue of dealings between the lender and the principal, the Personal Guarantor's liability under the guarantee may be discharged or reduced unless the guarantee expressly provides otherwise. Such circumstances may include the following:

- The lender agrees to give extra time to the principal to repay;
- The principal has been released from its obligations by operation of law;
- The principal contract between the lender and principal has been varied without the consent of the Personal Guarantor;
- Release of a co-Personal Guarantor from its liability;
- The Personal Guarantor executes the guarantee on the basis that the lender will take certain security from the principal or there will be other Personal Guarantors and such security is not taken or retained, or if the other Personal Guarantors do not execute the guarantee or limit their liability under it; or
- Where there are dealings between the lender and the principal or between the lender and any co-Personal Guarantor and these have the effect of varying the liabilities of the Personal Guarantor or of prejudicing the exercise of his or her rights.

For this reason before making a demand on the Personal Guarantor it is necessary to check whether any of the above have occurred and, if so, whether the guarantee includes provisions waiving defences of this nature. The lender should, however, be cautious about relying on such provisions in relation to a variation of the principal contract referred to at paragraph (e) above. In *Triodos Bank NV v Ashley Charles Dobbs*¹ a reminder was provided that if the guarantee is for a particular facility, which is varied so fundamentally as to amount to a new facility, the guarantee may not cover that new facility. It is therefore prudent to obtain the Personal Guarantor's consent to any variations or replacement of the underlying facility as and when they are made.

Immediate Recourse

The guarantee should be reviewed to determine whether it includes a clause which provides that the Personal Guarantor waives any right he/she may have of first requiring the lender to make demand upon, proceed against or enforce any other rights or security or claim payment from or claim in any insolvency proceedings against the principal or any other person before

claiming from the Personal Guarantor under the guarantee. The purpose of such a clause is to override any requirement either to make a demand first on the principal or take proceedings first against the principal and possibly obtain judgment before pursuing the Personal Guarantor.

Conditionality of the Personal Guarantee

The guarantee should be reviewed to determine whether there are any conditions precedent to the Personal Guarantor's liability which would have to be fulfilled before the lender could have recourse to him or her. Guarantees generally provide that the Personal Guarantor "unconditionally" guarantees and the use of this word "unconditionally" is intended to make it clear that there are no conditions precedent to the Personal Guarantor's liability and that the Personal Guarantor will be liable to discharge the guaranteed obligations immediately on demand for whatever reason by the lender.

Foreign Guarantors

Specific local law advice will be required where the guarantee is given by an individual who is located in a foreign jurisdiction and/or the guarantee is governed by a law other than the laws of England. In particular, difficulties may be encountered with service of notices of demand in the absence of a particular nominated person being authorised under the terms of the guarantee to accept service in England on behalf of the particular foreign Personal Guarantor. Where the Personal Guarantor resides outside of England (and in particular outside the EU) the lender should ensure that the guarantee includes such a nomination. Otherwise, in each case, specific local legal advice will be required before a lender takes any steps to enforce the guarantee.

Duress, misrepresentation and undue influence

As a general principle, a guarantee may be set aside if it is procured by misrepresentation or undue influence of the principal or the lender. A lender should of course be cognisant of these general contractual defences when obtaining a guarantee from an individual in a lending transaction, as they may provide a defence to a Personal Guarantor and ultimately create obstacles to the enforcement by the lender of the guarantee which it had relied on. In the case of potential undue influence, a lender shall always insist that the Personal Guarantor receives independent legal advice before executing the guarantee. Again, further specific advice can be given on these issues where the circumstances demand it.

Pursuing the Personal Guarantor following demand

If the Personal Guarantor does not respond to the demand and the lender is not holding cash or other security from the Personal Guarantor, then there are generally two options available to the lender, either to (a) commence legal proceedings against the Personal Guarantor or (b) petition for the Personal Guarantor's bankruptcy.

Commencing legal proceedings against the Personal Guarantor

The Personal Guarantor's assets

Before deciding whether to commence proceedings and/or petition for the Personal Guarantor's bankruptcy, the lender should consider whether the Personal Guarantor has sufficient assets to discharge his debt and where those assets are located. The lender would have made attempts to ascertain the Personal Guarantor's net asset position before obtaining the guarantee and checks should be made to establish if those assets (or any other assets) are still owned by the Personal Guarantor before commencing a claim. If the Personal Guarantor does not have sufficient assets to cover the debt owed (or those assets are heavily secured in favour of other creditors) or the relevant assets are in a foreign jurisdiction with no prospect of successful enforcement then it may not be worth proceeding with the claim. If the lender is uncertain about the Personal Guarantor's assets then it should make the necessary enquiries which may include:

- Instructing an enquiry agent / asset investigator. However, the lender must ensure that the enquiries are conducted in accordance with all local laws.
- Checking the Insolvency Register to see if the Personal Guarantor is bankrupt or subject to an individual voluntary arrangement, debt relief order or any bankruptcy restriction order and undertaking.
- A land registry title register search to establish ownership for any address it has for the Personal Guarantor.
- Inspecting the charges register for any registered property will also ascertain whether it is charged and to whom.
- Checking the Register of Judgments, orders and fines.
- Searching against a company or limited liability partnership at Companies House for companies associated with the Personal Guarantor or carrying out a director search against the Personal Guarantor to establish other companies associated with him or her.

If the lender has any basis for concern that the Personal Guarantor will attempt to dissipate assets which could be used to satisfy a judgment debt, then the lender should consider taking immediate steps to prevent this. This may include seeking a freezing order to freeze the assets of the Personal Guarantor in this jurisdiction (and possibly other jurisdictions) pending court proceedings.

Choosing the Court

Before issuing a claim against the Personal Guarantor, the lender should consider carefully where to commence proceedings. Any choice is likely to be determined by any jurisdiction clause in the guarantee. This may provide for one country's courts to have exclusive jurisdiction, or it may provide for non-exclusive jurisdiction thereby giving a range of possible choices, or any dispute may be referable to arbitration or other form of dispute resolution. The lender should consider where the assets of the Personal Guarantor are located before issuing the claim (and indeed upon taking the guarantee). Various jurisdictions do not have reciprocal enforcement provisions and/or do not recognise

English High Court judgments. If, for example, the Personal Guarantor's assets are located solely in Russia, then it will prove very difficult to enforce an English High Court judgment. Where there is provision for arbitration, however, awards can be enforced under the 1958 New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards. If the claim is to be issued in the English High Court (generally for claims of £50,000 and higher), the lender will need to decide which division of the High Court to issue the Claim. A claim against a Personal Guarantor should ordinarily be commenced in the Queen's Bench Division. It may be appropriate to commence a claim in the Commercial Court (a specialist division of the Queen's Bench Division) if the claim is deemed to be a 'commercial' claim which includes any claim relating to a business document or contract or banking and financial services.

Progressing a Claim

Proceedings will have to be issued and served upon the Guarantor. A process agent clause in the guarantee makes service of proceedings upon a foreign defendant considerably more straightforward.

Consideration will also have to be given to the circumstances in which a default judgment might be obtained if the defendant does not defend the proceedings. Issues as to the enforceability of a default judgment may arise. Consideration should also be given to the availability of some form of expedited or "summary" judgment. For example, in the English High Court where a defendant has no real defence to a claim, judgment can often be obtained through a summary judgment procedure within three to four months of proceedings being commenced, rather than the twelve to eighteen months that a full trial may take.

Bankruptcy

Rather than commencing a claim against the Personal Guarantor, it may be more cost effective to commence bankruptcy proceedings against the debtor. However, such proceedings are only appropriate if the debt is admitted, or not capable of being disputed in any way at all, even on spurious grounds otherwise, there is a risk that the bankruptcy proceedings will be set aside. A lender can present a bankruptcy petition if the Personal Guarantor owes more than £750 to the lender and cannot pay that debt. It is generally advisable for the lender to serve a statutory demand on the Personal Guarantor first (subject to the above caveat that the debt should be undisputed or not capable of being disputed). This is not a Court document but a formal demand which gives the Personal Guarantor 21 days to pay the debt demanded by the lender. If the Personal Guarantor fails to pay, secure, or reach a settlement with the lender within 21 days of service of the demand then the Court will regard the Personal Guarantor as unable to pay his debts for the purposes of the bankruptcy proceedings.

Assets of bankrupt's estate

If made bankrupt, the Personal Guarantor's bankrupt estate vests in the Trustee in Bankruptcy upon his appointment. The debtor's

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bankrupt estate comprises of all assets and property in which the debtor has a beneficial interest at the date of the bankruptcy order, except the tools of the debtor's trade, assets necessary for the basic domestic needs of the debtor and his family, assets to which the debtor has sole legal title (such as assets held on bare trust and property held by the debtor under an assured tenancy, protected tenancy or protected occupancy of a dwelling house.

Any money in a bankrupt's bank account at the date of the bankruptcy order is property of the bankrupt. The beneficial interest of the bankrupt in his own sole or principal residence (or his interest in the sole or principal residence of his present or former spouse or partner) will vest in the debtor's Trustee in Bankruptcy. If the bankrupt is the sole owner, legal title to the principal residence will also pass to the trustee.

The family/matrimonial home will often be the main asset in the bankrupt's estate. If a co-owner has a legal and beneficial interest in the property and refuses to sell the property, the Trustee in Bankruptcy must apply to the court for an order of sale. If the property is eventually sold, only the bankrupt's share of the proceeds of sale will vest in the estate.

A spouse who does not have any legal interest in the family home may still have rights of occupation, known as 'matrimonial home rights', which may be legally protected by registration. A trustee in bankruptcy can apply to the court for an order for the sale of the bankrupt's family home. After one year has passed since the vesting of the bankrupt's estate in the trustee, the Court will assume that, unless there are exceptional circumstances, the interest of the bankrupt's creditors outweigh all other considerations.

Advantages

- The bankrupt has a general duty to co-operate with the Trustee in Bankruptcy.

Disadvantages

- Doesn't necessarily ensure that the debt will be paid (there may not be sufficient assets).
- Rights of occupation may delay the trustee obtaining an order for possession / sale which may be an issue if the matrimonial home is the main asset.

Recovery of debt

Enforcement of a judgment against the Personal Guarantor

If the lender is successful in obtaining a judgment against the Personal Guarantor for payment of the debt owed pursuant to the guarantee, then the lender may enforce the judgment to recover payment of the amounts owed by the Personal Guarantor. Before deciding how to go about enforcing a judgment against the Personal Guarantor, the lender should re-assess the Personal Guarantor's asset position (as set out above). In addition, the lender should reconsider whether there is a risk of the dissipation of any assets. The method of enforcement will generally depend

on what assets the Personal Guarantor owns. If it is proving difficult to establish what assets are owned by the Personal Guarantor, it is open to the lender as the judgment creditor to apply for an order requiring the Personal Guarantor to attend court to provide information about his means, or any other matter about which information is needed to enforce a judgment or order. This can be a useful tool available to the lender to obtain information about the Personal Guarantor's assets so that the lender can best decide which enforcement procedure(s) to use. The threat of an oral examination may in some cases prove sufficient for the Personal Guarantor to pay the sums owed.

Execution against goods

This allows a High Court enforcement officer to seize and sell at auction enough of a debtor's goods in order to obtain the funds to satisfy a money judgment. The following cannot be seized:

- Goods not owned by the debtor, for example, goods subject to a hire purchase agreement or conditional sale or finance lease or transferred pursuant to a bill of sale.
- Trust assets, unless the whole beneficial interest in the goods is vested in the debtor.
- Interests in land and fixtures upon land.
- Exempt goods such as tools, books, vehicles and other items of equipment as are necessary to the execution debtor for use personally by him in his employment, business or vocation; or clothing, bedding, furniture, household equipment and provisions as are necessary for satisfying the basic domestic needs of the execution debtor and his family.
- Crown property. A separate procedure exists to enforce judgments against the Crown. This is set out in section 25(1) to (3) of the Crown Proceedings Act 1947.
- Goods already seized under another writ of *fi fa*.

Unless the Personal Guarantor makes payment, his goods must be sold following their being seized by the enforcement officer. Sale is normally by public auction, although goods can be sold by private tender with the agreement of the Court.

Advantages

- Relatively inexpensive and quick procedure.
- Simple and straightforward procedure which does not require a judicial decision.

Disadvantages

- Entry into a house or premises cannot be forced so seizure of goods can be limited in practice if the High Court Enforcement officer or bailiff is not granted access.
- Not all types of goods can be seized.

Charging Order

A charging order imposes a charge over the Personal Guarantor's beneficial interest in land, securities or certain other assets. The charge is the amount which the creditor is owed under the terms of the judgment (plus accrued interest and costs). A charging

order prevents the Personal Guarantor from selling his assets without paying the lender what is owed. It does not allow the lender to recover payment of the debt (that requires an order for sale) but it may safeguard or secure payment for the future.

Charging orders take effect as an equitable charge on the Personal Guarantor's property. They take effect subject to prior charges. If, for example, the property to be charged is a house, the charging order will take effect subject to any prior charges, such as bank or building society mortgages and will be over the Personal Guarantor's share of the beneficial interest in cases of co-ownership.

If a final charging order is obtained, then the lender may apply for an order for sale. There is no limitation period for applying for an order for sale. If, for example, property prices are dropping, the lender may wish to wait until prices increase as this may have an effect on whether there is sufficient equity in the property. When considering the grant of an order for sale, the Court will look at all the circumstances of the case and will exercise its discretion. The Court has acknowledged that making an order for sale is an extreme measure, especially when it is dealing with the debtor's home. Where the Personal Guarantor co-owns the property with a third party, the exercise of the Court's discretion as to whether or not to order a sale will be a balancing act between the interest of the co-owner and the creditor being kept from recovering its money by enforcing the charging order.

Advantages

- Effective method of enforcement when there is substantial equity in a property and the judgment debtor is the sole owner.
- Can be used in conjunction with other enforcement methods.

Disadvantages

- It is an equitable charge and therefore subject to any prior charges on the property.
- Does not in itself realise funds; this requires an order for sale which is not necessarily granted. The interests of other secured creditors and co-owners will be taken into account.

Third Party Debt Order

A third party debt order freezes amounts owed to the lender which are in the possession/control of third parties, such as a bank. A third party debt order is most commonly used to prevent the Personal Guarantor from withdrawing money out of a bank or building society account held otherwise than with the lender. The money held by the third party must be held solely for the Personal Guarantor (i.e. an order cannot be obtained in relation to a joint account).

Advantages

- Effective way of recovering payment if sufficient monies to satisfy judgment can be identified.

Disadvantages

- Evidence to support an application can be hard to find (that a debtor is owed money by a third party or has a bank account and the amounts in question).
- They can only be used to attach money owed to the judgment debtor and not against any of the judgment debtor's other property.
- It is not available against a joint bank account unless the judgment debt is owed by all the account holders.

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