FOUR FAST FACTS

ON: BASIC GUARANTEE CONCEPTS

NOVEMBER 2021

1 What is a guarantee?

The subject of guarantees is complex. This publication touches on some of the headline guarantee concepts.

A guarantee is a common commercial arrangement that obligates a third party (the guarantor) to answer for the debt of a borrower. They are taken as a back-up, in case the borrower doesn't pay the debt when due.

Guarantees are usually accompanied by an indemnity, and describe the guarantor as a principal debtor as well as a guarantor - giving lenders the option to pursue the guarantor for payment of the debt without first having to claim against the borrower.

2 Types of guarantees

There are three main forms of guarantee:

- Unlimited – given by one or more guarantors for all obligations of the borrower to the lender (most common).
- Limited – where a lender's recourse is restricted - for example to a specific amount, facility or percentage of the debt (less common).
- Cross – given by multiple guarantors who guarantee each other's debts in addition to the borrower's debts (common in group structures).

3 Lenders' rights

A guarantee is a promise to pay a borrower's debt. It is not *security* for those debts.

A lender can enforce a guarantee by demanding payment by the guarantor of unpaid guaranteed debt. This claim is an unsecured claim and would rank behind any secured creditors of the guarantor if insolvency proceedings were commenced against the guarantor.

If a lender wishes to have security for the debt (and therefore be a secured creditor), it must also take a security interest in the guarantor's assets through a security agreement.

4 Enforceability considerations

There are a number of issues that can complicate or block enforcement of guarantees. They include:

- Material variation of the underlying agreement without the guarantor's consent (protection against which can be drafted into the guarantee – see our commentary on a recent Court of Appeal decision).
- Undue influence, where the guarantor has been influenced to enter into the guarantee by the borrower, and the guarantor hasn't taken independent legal advice.
- Corporate benefit, solvency and other considerations specific to companies.

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