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Undoubtedly, if your filing cabinets are like those found in most businesses, they are likely to contain items that are long forgotten. However, because of the nature of many businesses, there may be several items located in your filing cabinets that could cause you tremendous distress and cost you or your businesses a tremendous amount of money.

The next several issues of the HLG Constructor will contain a series of articles regarding the “time-bombs” in your files. This edition will focus on personal guarantees included in credit agreements, confessed judgments/promissory notes, and in bonding agreements with sureties. Future editions will cover the unexpected effects and obligations of “flow-down” provisions, incorporation clauses, and warranties.

The personal guarantee is often overlooked or misunderstood at the beginning of a project or business relationship. Even if it were considered at the outset, its importance is often erroneously minimized and it often ends-up filed away and forgotten. This seemingly harmless document typically explodes when the project is not going well or the business is having cash-flow problems. At that time, it is often too late to do

anything about it or take any steps to protect yourself and your business.

Personal guarantees are promises or undertakings that an individual or individuals will satisfy an obligation that an entity has undertaken but fails to satisfy. Personal guarantees are typically made by principals or officers of companies and are most often encountered in credit applications from suppliers. These guarantees are usually signed when the company is young or when a new supplier is needed. Personal guarantees are also commonly found in promissory notes, settlement agreements, and fee arrangements.

From the creditor’s perspective, a personal guarantee is a form of collateral from an actual person for the extension of credit to a business since businesses, other than sole-proprietorships, are usually legal fictions. Possessing a personal guarantee gives the creditor a person to go after if the business fails to pay its obligations. While most personal guarantees are executed by corporate officers or principals, many times, they are executed by the treasurer or comptroller of a company. Sometimes unwitting employees sign and submit credit applications, not realizing that they may be obligating themselves personally in the event of non-payment by the company.

Moreover, many sureties require personal guarantees from the principals of the business for which they provide a bond. Often these personal guarantees accompany indemnification agreements which require the business to repay the surety for any money that the surety has to pay on behalf of the business. Accordingly, when the indemnification provisions include personal guarantees by the principals or corporate officers, they become liable in the event that the surety pays. Additionally, most indemnification obligations also provide for reimbursement of costs associated with claims made against the bond including attorney’s fees, court costs, investigation costs, and expert fees.

Problems arise from personal guarantees when the business fails to fulfill its obligations and the creditor or surety looks to the person that signed the guarantee to fulfill the obligation. Many times the creditor or surety is forced to go to the personal guarantee because the business has fallen behind on payments or has failed to pay altogether. Typically, the principals of the business may also be experiencing financial hardships at the same time. Nevertheless, the personal guarantee will operate to endanger the personal assets of the person that signed the guarantee (the guarantor).

Time-Bombs Continued

Courts have upheld personal guarantees by corporate officers and company principals for centuries. Barring the existence of fraud in inducing the guarantor to enter in the obligation, they are very difficult to defeat and are typically upheld. Even if a corporate officer leaves the company, their personal guarantee obligations may continue. Accordingly, corporate officers or principals should carefully note each time they undertake a personal obligation on behalf of the business and should consider a means of protecting their personal assets beyond the traditional formation of LLC's, LP's or Corporations.

In the worst cases, the guarantor was an accounts payable clerk who signed a credit application from a vendor and was sued by the vendor to recover when the company has not paid. The good news for this employee is that the courts have traditionally not enforced such obligations on the employee if the employee did not receive consideration for undertaking the obligation. The bad news for the employee is that the courts across the country are not clear on their application of this maxim or on how to define adequate consideration in this situation. The worst news for these employees is typically they will have to hire their own lawyer to defend them from the lawsuit as the company cannot afford to defend them or the company's lawyer cannot represent both the employee and the company due to conflicts of interest.

There are additional steps that can be taken to minimize the impact of personal guarantees or eliminate them altogether. First, as many of

these guarantees were made at the outset of a business relationship with vendors, suppliers, or sureties as collateral, they can be revisited or renegotiated at your request, once the company establishes a track record with the creditor. Many suppliers, vendors, and sureties will release the personal guarantee based upon your company's good payment history and credit relationship. However, don't expect to get a surety to release a personal guarantee which protects a bond it has already issued and for which payment obligations may still exist unless you are willing to offer some other sort of collateral to cover the obligation.

Sometimes, vendors and suppliers will release the personal guarantees in exchange for faster payment terms and/or a higher finance charge on payments beyond a certain age. If your company has always paid its bills on time with a vendor, they will likely be willing to work with you. Nevertheless you should remember that credit managers and sureties are inherently averse to risk. So, be prepared to make your case by showing your payment history with them and possibly other vendors as well.

When you are successful at renegotiating your credit agreement, care should be taken to assure that the personal guarantee is actually and finally released and the credit agreement is actually modified to reflect the release of the personal guarantee. An attorney should review any modifications to personal guarantees to verify that they comply with and are not contradictory to any contractual and legal requirements. Any modifications to personal guarantees should also be signed and witnessed by both parties.

Conclusion

Personal guarantees are an unavoidable certainty in the construction industry to-

day. They are an effective way for vendors, suppliers, and sureties to secure their risk when providing services, materials or bond coverage. Personal guarantees are so prevalent in the everyday business of the construction industry they are often quickly forgotten or their possible importance is minimized until a company experiences cash-flow issues or a project goes terribly wrong. Fortunately, through understanding the obligation included in each personal guarantee and careful planning you can avoid surprises and minimize the impacts of personal guarantees. Moreover, by proactively revisiting your existing personal guarantees with suppliers, vendors, and sureties, you may be able to avoid personal obligations altogether.

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