

IS IT REALLY A PERSONAL GUARANTEE? ANOTHER PERSONAL GUARANTEE GONE WRONG

Creditors are often faced with disputes by guarantors over the validity and enforceability of a guarantee following a failure by the principal to pay a debt.

Poorly drafted and ambiguous personal guarantees can give rise to guarantors being wrongfully released from liabilities, or alternatively documents being signed which are unenforceable and ultimately worthless.

The recent decision by the Supreme Court of New South Wales in the matter of *Aquawest Pty Ltd v Twynham* [2017] NSWSC 652 is yet another reminder of the court's reluctance to enforce a personal guarantee where the drafting contains ambiguities.

The decision

Aquawest Pty Ltd (**Aquawest**) was a supplier of irrigation services and equipment.

In February 2013, Aquawest entered into an agreement with Chatoyer Holdings Pty Ltd (**Chatoyer**) for the supply of goods and services on credit.

The credit application was completed on behalf of Chatoyer by Mr Paul Twynham, the director of Chatoyer.

The following words appeared immediately above the signature of Mr Twynham.

I certify that the above information is true and correct and that I am authorised to make this application for credit. I have read and understand the TERMS AND CONDITIONS OF TRADE (overleaf or attached) of Aquawest Pty Ltd T/A Aquawest Plumbing & Irrigation Specialists which form party of, and are intended to be read in conjunction with this Credit Account Application and agree to be bound by these conditions. I authorise the use of my personal information as detailed in the Privacy Act clause therein. ***I agree that if I am a director/shareholder (owning at least 15% of the shares) of the Customer I shall be personally liable for the performance of the Customer's obligations under the contract.***

The space for execution on the credit application included one space to sign on behalf of the applicant customer. There was no separate signing space to sign as a guarantor.

In May 2014, Chatoyer was placed into liquidation and Aquawest subsequently commenced proceedings against Mr Twynham personally, seeking to rely on above clause.

The primary issue for the Magistrate to determine in the proceeding was whether the clause was effective and enforceable as a personal guarantee against Mr Twynham in respect of the debts owing by Chatoyer to Aquawest under the credit agreement.

At first instance, the Magistrate considered that the clause was:

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1. poorly drafted for a number of reasons;
2. truly ambiguous; and
3. gave rise to three following potential interpretations.
 - (a) A shareholder (owning at least 15% of the shares) of the Customer, but not a director of the Customer.
 - (b) A shareholder (owning at least 15% of the shares) of the Customer, and also a director of the Customer.
 - (c) A director of the customer, but not a shareholder of the Customer (or a shareholder owning fewer than 15% of the shares in the Customer).

The Magistrate held that due to the ambiguity of the clause he could not be satisfied that Mr Twynham was executing the document in his personal capacity as guarantor and not just as someone simply accepting the terms and conditions on behalf of Chatoyer.

Aquawest appealed the decision of the Magistrate to the Supreme Court of New South Wales on the basis that the Magistrate erred in his construction and interpretation of the clause.

On appeal, Lonergan J agreed with the decision of the Magistrate that due to the ambiguity of the clause he could not conclude that the credit agreement was being executed by Mr Twynham in his personal capacity as a guarantor.

His Honour held that:

1. in construing the clause and the guarantee as a whole, the Court's task is to construe it in its commercial setting in accordance with the surrounding circumstances known to both parties; and
2. any clause or document purporting to be a guarantee must be construed strictly and in the case of any ambiguity, the clause will be construed in favour of the guarantor.

The appeal was dismissed with Aquawest ordered to pay Mr Twynham's costs of the appeal.

General requirements of a guarantee

The decision demonstrates the importance of ensuring that any document that purports to give rise to a personal guarantee complies with the requirements to be enforceable at law.

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Legislation in each state mandates that in order for a personal guarantee to be enforceable it must be in writing and executed by the guarantor (or some other person that is lawfully authorised to sign on behalf of the guarantor).

A guarantee is ultimately a contract between the parties so the general requirements of a contract are applicable being offer, acceptance, intention to create legal relations and consideration.

In *Aquawest*, it could not be concluded that Mr Twynham in his personal capacity intended to create a legal relationship with Aquawest and as such, no contract of guarantee could come into existence.

However, the general contractual requirement of consideration is not required if the guarantee is executed as a deed.

Top tips for obtaining and enforcing personal guarantees

A personal guarantee is one of most effective legal recovery tools in a creditor's arsenal.

Despite this, it is astonishing the number of creditors who are seeking to rely on:

1. unsigned guarantees;
2. discharged or unenforceable guarantees; or
3. poorly drafted guarantees.

Poor drafting and the absence of a number of key clauses (as was the case with the credit application in *Aquawest*) can lead to a signed and enforceable guarantee being discharged by law.

For example, a guarantee can be discharged by the following.

1. The guarantee provides for execution by two or more persons and is not executed by all persons contemplated in the guarantee.
2. The principal debtor is provided with an indulgence or further time to pay.
3. The principal agreement is varied (for example by issuing new terms and conditions of sale or increasing a credit limit) without the consent of the guarantor.
4. If there are two or more guarantors, one of the guarantors is released from liability, meaning if you release one guarantor you release all of them.

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A well drafted guarantee will provide that a guarantor's liability will be not be discharged in the event that any of the above (or multiple other situations) occur.

With the above in mind, the following are our top five tips for when you are obtaining personal guarantees.

1. Have your principal agreement (such as your credit application), terms and conditions and guarantee reviewed by a specialist solicitor prior to issuing it to prospective customers and guarantors.
2. Ensure the guarantee is signed and witnessed (with sufficient personal details of the witness to locate them if it is necessary to contact them in the future to confirm the execution of the document).
3. Obtain the original copy of the guarantee from the guarantor.
4. Verify the identity of the guarantor.
5. Upon approval of the credit facility, send a letter to the guarantor directly to inform them that the application has been approved based on their guarantee.

A personal guarantee should be a simple and effective tool in assisting you with the recovery of debts, however, there are significant issues that may arise if the guarantee is poorly drafted.

For this reason, it is more important than ever to ensure that appropriate measures are in place to ensure that every personal guarantee obtained is enforceable against the guarantor and is not inadvertently discharged by your own conduct.

The harsh reality is that by the time some creditors are finding this out, it is too late and their only recourse is to lodge a proof of debt in the insolvent principal debtor's liquidation as an unsecured creditor (with often little to no prospect of recovery).

When the time comes to call on a personal guarantee you need it to be watertight. Spending the time to get it right at the outset will save you significant time and costs associated with disputes that will arise over a poorly drafted guarantee.