



GUARANTEES: WHAT HAPPENS WHEN A GUARANTOR DIES?

Introduction

For business owners and investors, signing a related personal guarantee has become an accepted “standard practice”. As a result, individual owners are unknowingly putting their personal assets and business assets at risk.

A personal guarantee will usually last as long as the associated debt is outstanding. If you die while the personal guarantee is still alive, what does that mean for your estate?

What is a “Personal Guarantee” (hint: it’s usually, actually, a Guarantee & Indemnity with Securities)?

Guarantee

A contract of guarantee arises where one person contracts with another to pay some debt or perform some act or duty, owed by a third person who remains primarily liable for such payment or performance.

The person giving the guarantee only becomes liable on the default of the third person.¹ Without a principal obligation, there can be no accessory obligation of guarantee.

The essential common law requisites of a guarantee do not differ from those of any other contract, and involve:

- the mutual assent of two or more parties;
- competency to contract on the part of those entering into it; and
- where the agreement is not under seal, valuable consideration, which may be entire or fragmentary.

The absence of any one of these requisites is as fatal to the formation of the contract of guarantee as it is to the formation of any other contract.

¹ *Coutts & Co v Browne-Lecky* [1947] KB 104 at 111); [1946] 2 All ER 207 at 210.



Indemnity

An indemnity may be defined as a contract by which one person agrees with another to make good all loss which that other person may suffer by:

- doing some act,
- exercising some forbearance, or
- assuming some liability,

at the request of the person by whom the indemnity is given or of some third party.

The parties to a guarantee contract are:

- *The Creditor* – The person receiving the benefit of the guarantee is called the creditor. This is usually the bank, finance company, supplier or lender.
- *The Principal Debtor* – The person who is borrowing the money or obtaining the benefit of the contract.
- *The Guarantor* – The person who provides the guarantee is called guarantor.

What are the risks of being a guarantor?

While the ideal situation would be for the Guarantor to act as a third party that doesn't have to contribute any money to a loan repayment, there are some dangers.

If the Principal Debtor defaults on the loan, the debt becomes the Guarantor's responsibility, and it could mean the Guarantor may have to sell their own home to service or clear it.

In the event a Guarantor dies during the term of the guarantee, the debts do not die too. As with ghosts, they live on to haunt the Guarantor's estate.

What are the types of Guarantees?

Guarantees can be either divisible or entire:

- *Divisible guarantee*: This is a type of guarantee which the Guarantor continuously guarantees further obligations over the life of the guarantee.² For example, a company Director providing a personal guarantee to Creditor in exchange for the Creditor providing goods or services to the Director's company from time to time.
- *Entire guarantee*: This is a type of guarantee where the Guarantor guarantees payment of one supply or loan only. For example, a parent giving a personal guarantee for their child's loan, this would be classified as an entire guarantee as it concerns a single amount.

Can a death revoke a guarantee?

The simple answer is "Yes". If the consideration of the guarantee is divisible, the guarantee can be revoked³ once notice of the death of the Guarantor is received by the Creditor.

² Caltex Australia Petroleum Pty Ltd v Troost [2015] NSWCA 64 at 74.

³ Caltex Australia Petroleum Pty Ltd v Troost [2015] NSWCA 64 at 7; also Coulthart v Clementson (1879) 5 QBD 42 at 46-7; Re Nicholson; Ex parte Totterdell [1989] FCA 182 at [19]



If the consideration of the guarantee is entire, the Guarantor's estate will be liable for the total amount guaranteed.

Wording of the guarantee help it survive death

If the wording of the guarantee specifically states that the guarantee is continuing and not revoked by death or the guarantee extends to the Guarantor's executors or personal representatives, there is a good chance that it will survive the death of the Guarantor, allowing a Creditor to make a claim on the Guarantor's estate.

This is the case even if the guarantee is a divisible guarantee and the Creditor has received notice of death of the Guarantor.

What if you are a Co-Guarantor

Generally, where there is more than one Guarantor, a guarantee will often be expressed as being 'joint and several'.⁴ This effectively means each Guarantor is liable separately from, as well as along with, other Guarantors. In the event of a sudden death of one Guarantor, the death of one Guarantor will not release or affect the remaining Guarantors' obligations under the guarantee.

What is Guarantor Protection Insurance?

Guarantor Protection Insurance is a cost-effective and logical solution which ensures that on the death of a Guarantor or total and permanent disablement of a Guarantor, the debts guaranteed by the Guarantor is fully repaid.

The business owners and Guarantors are protected from the ramifications of being forced to liquidate their assets to repay the loan. While this primarily benefits the guarantor and his or her estate in protecting personal assets, it also has benefits for surviving principals.

With the debt repaid, the business owners and guarantors are freed from further financial burdens at a time of stress.

Factors to consider before signing a guarantee

It is advisable to consult your lawyer so that your rights and liabilities can be properly explained to you. Each guarantee is different and turns on the clauses set out in the agreement. Therefore, it is imperative that you understand the legal consequences of signing on as a Guarantor.

Personal guarantees can be powerful when drafted well, and used correctly.

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⁴ Lavin v Toppi [2015] HCA 4