

THREE CRITICAL ASPECTS OF PERSONAL GUARANTEES ON BUSINESS LOANS

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Overview

Business owners are often required to sign personal guarantees on business loans. Lenders may need additional security on the loan or may just want the owner to have personal "skin in the game."

A personal guarantee, in this circumstance, is a legal contract made by a business owner agreeing to become liable using his or her own personal assets in case the business is unable to repay the loan.

Examples:

- *Capitol Grp., Inc. v. Collier*, 365 S.W.3d 644, 648 (Mo. Court. App. 2012);
- *Jamieson-Chippea Inv. Co., Inc. v. McClintock*, 996 S.W.2d 84, 87 (Mo.App. E.D. 1999);
- *Mercantile Trust Co. v. Carp*, 648 S.W.2d 920, 923 (Mo. Court. App. 1983).

Depending on the language of the guarantee, the lender may be able to collect first from the guarantor, rather than the business, if it elects to do so. 38 Am. Jur. 2d Guaranty § 84, Westlaw

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Before signing such guarantees, business owners should educate themselves and understand the potential implications of doing so. Although there are many aspects of personal guarantees to be considered, three stand out and should be understood before signing.

1. Business owners should negotiate for limited personal guarantees over unlimited ones.

First, business owners must understand there are two types of personal guarantees: limited and unlimited. And, to the extent possible, business owners should negotiate for limited personal guarantees over unlimited ones.

In unlimited personal guarantees, business owners are responsible for covering the total loan amount if the borrower fails to satisfy the debt—including any associated legal fees. For business owners, there is no cap on unlimited personal guarantees. Limited personal guarantees, on the other hand, create a limit, or cap, on the amount that the business owner may owe in the event of default.

Where possible, business owners should negotiate for a specific limited dollar amount of the personal guarantee. And in the case of partial ownerships, such business owners should negotiate to limit their guarantee to a percentage of the business debt based on their particular ownership interest.

For example, imagine someone owns only a 10% interest in a business and signs a personal guarantee in order for the business to borrow \$500,000.00. If that partial business owner does not negotiate a limit on the guarantee, he or she would be personally liable for the full amount of the debt. Even if there are other guarantors, the lender could choose to collect the full amount of the debt from a single guarantor.

In addition, lenders may ask business owners for a spousal guarantee. This type of guarantee, as defined under the Equal Credit Opportunity Act, may be prohibited under certain circumstances. Business owners should be aware of the possible illegality of that spousal requirement and proceed with caution.

2. Business owners must understand that many personal guarantees include a waiver of any and all defenses, except payment in full.

Most personal guarantees—both limited or unlimited—include a waiver of any and all defenses, except payment in full. It is vital for guarantors to understand the consequences of such a waiver. If a guarantor signs a personal guarantee with such a waiver, the guarantor may be unable to assert any type of defense to the lender's claims against them—no matter how egregiously the lender may have acted.

See *Landmark Bank of St. Charles Cty. v. Saettele*, 784 F. Supp. 1434, 1440 (E.D. Mo. 1992). For example, if a business owner signs a personal guarantee based on fraudulent misrepresentations of bank officers, that business owner is still responsible for the unpaid debt and cannot assert the fraud as a

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defense. Business owners should pause long and hard before signing personal guarantees with such waivers.

As a result, if the borrower receives additional credit from the lender, even without notice to the guarantor, the guarantor may be liable on the guarantee for that additional credit. The only way to cut off liability for additional debt is to revoke the guaranty.

Please be aware that revocation of the guarantee may be an event of default for the borrower under the loan. However, if a guarantor is a minority or silent partner in a business that is having trouble and racking up debt, revocation may be the best move. Let's return to the example of the guarantor who owned 10% of a business that now has \$2 million in debt. That partial business owner could have exercised his or her right to revoke the personal guarantee at an earlier date and limited his or her liability.

Conclusion

Before signing personal guarantees on business loans, business owners must carefully weigh the potential benefits and consequences. First, they must understand the difference between limited and unlimited personal guarantees and try to negotiate a limited guarantee. Second, business owners must understand that their personal guarantee likely includes a waiver of any and all defenses, even including bad faith lending. Finally, business owners should educate themselves about their right to revoke their personal guarantee.

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