

News with Clout

Providing Corporate & Personal Solvency Solutions

PERSONAL GUARANTEES COME BACK TO BITE FORMER DIRECTORS

As we are all aware, despite the alleged comfort of incorporation, part of the modern environment for doing business will be the signing by directors or corporations personal guarantees wrapped up in the original application for supplier credit. Until an insolvency event looms on the horizon these guarantees are generally never thought of again.

As an aside, this is a great reason why, before embarking on any venture, families should give some thought as to defensive structures that are inexpensive and not that difficult to implement with one party holding the assets whilst the other does the business.

Now to a recent matter highlighting the pitfalls. This certainly was an ugly one. A company obtained a trade account from a supplier which included the company's four directors and shareholders executing personal guarantees. Sometime later three of the directors and shareholders sold their shares in the company to the remaining director and shareholder and ensured all outstanding accounts were paid at that time and resigned their directorships.

The company continued to trade its business, under the now sole director and shareholder, for a while but eventually became insolvent and had no choice but to go into creditors voluntary liquidation. Insufficient recoveries were made in the liquidation to pay all creditors in full. Yes, you guessed it the personal guarantees reared their ugly heads!

The sole director and shareholder did not have the financial capacity to satisfy the claims under the personal guarantees and was left with no alternative but to submit a Debtor's Petition for bankruptcy.

The former directors and shareholders became the next targets of the unpaid creditors despite no debts being due at the time of exit and the fact they were no longer directors.

The former directors and shareholders were required to pay the outstanding amount due to the supplier, a debt which was incurred after their tenure. Ouch!

It appears a personal guarantee can only be removed by formal notification to the financier or supplier, which is hardly fair in the circumstances, and there may even be the need for an acknowledgement. Certainly, it must be felt that some consent to the removal would be added comfort.

The error here would not appear to be one made by any professionals involved in the transaction but the failure to use a professional.

Apart from our suggestion for any business owners to structure themselves against this eventuality, we recommend keeping a file of all personal guarantees, by directors so they are aware of their ongoing exposures.

As always, we welcome your enquiries.



NEWS WITH CLOUT

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