

# TRADIE LAW FACT SHEET #26

## PROTECTING YOU AND YOUR BUSINESS

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### Guarantees

#### OVERVIEW

You've been asked to sign a guarantee, probably by a bank or trade supplier. What does it mean? Should you do it?

As the vast majority of New Zealand's business environment is made up of small to medium enterprises (**SMEs**), guarantees, come up all the time. Despite that, guarantees aren't well understood. We find that people routinely sign a guarantee without realising, or without understanding what it actually means for them. Unsurprisingly, that leads to problems down the track when a creditor or debt collector comes calling.

Here you'll find the answers common questions we encounter when advising clients about guarantees.

- **What is a guarantee?**

A guarantee (sometimes called a guarantee and indemnity), is a significant legal agreement. It means that the person signing the guarantee (the guarantor), promises to take on the liabilities or obligations of another person, entity or company, in favour of a third party creditor (such as a bank or trade supplier). Most commonly, guarantees arise where a company has a bank loan or credit account with a trade supplier, and the bank or trade supplier asks the company's directors and shareholders to sign a guarantee in respect of the company's debts. In that situation, the person providing the guarantee will become personally liable to the bank or trade supplier for all (or part) of the company's debts, when they would otherwise have had no personal liability to the bank or trade supplier.

- **Why have I been asked to give a guarantee?**

Banks and other creditors will request guarantees because they want to get greater security, or comfort, that the underlying debt will be repaid. Guarantees are a form of security, because it means that the bank/creditor can demand payment from both the underlying borrower and the guarantor – so there is a greater chance the debt will be paid in the end. For most small-medium sized companies, banks and trade suppliers will require guarantees from directors and/or shareholders before lending money. This is because the bank/trade supplier is worried that without a guarantee, if the company failed, there would be no one to chase for repayment of the debt. Banks/trade suppliers will usually also want guarantees from trustees, if the family home/main assets of shareholders are held in a trust.

- **What is an 'all obligations' guarantee?**

Most guarantees are 'all obligations' guarantees. This means that by signing the guarantee, you promise or agree to meet every obligation that the underlying debtor/borrower has to the creditor/lender that the guarantee is being given to. You will be required to make all payments that the borrower agreed to make, as well as be responsible for everything else the borrower agreed to do – such as provide financial statements or other information to the lender on request, keep mortgaged property insured, prevent or reduce harm/loss/damage being suffered by a mortgaged property, pay rates for a mortgaged property on time and so on. Basically, you become personally liable to do everything that the borrower is required to do under the underlying loan agreement/terms of trade.

- **What does indemnify mean?**

Most guarantees also include a requirement for the guarantor to “indemnify” the lender for the borrower's breach of contract. Indemnify is just a fancy legal word for “make good”. So, if you have agreed to guarantee a company or person's obligations to a bank, not only do you promise to do everything that the borrower is required to do, but you also promise to do everything required to make good on the borrower's breach of contract. Usually, this means you will reimburse/pay the bank for any losses it has suffered as a result of the borrower's breach – for example, payment of interest, penalties, legal fees, debt recovery costs and so on.

- **What's the difference between a limited and unlimited guarantee?**

An unlimited guarantee means that there is no limit on the amount that can be recovered from you by the bank/trade supplier who has the benefit of the guarantee. All amounts (including existing and future debt) can be recovered from you. A limited guarantee on the other hand means that while you are liable for all amounts (including existing and future debt), the maximum amount that the bank/trade supplier can actually recover from you is limited. This limit will be clearly stated in the guarantee itself, and usually it is expressed as a dollar amount “*plus interest and costs*”. If possible, it is always better to give a limited guarantee than an unlimited guarantee.

- **Surely the bank/trade supplier has to chase the borrower first, right?**

No, one of the key features of guarantees is that the guarantor agrees to become principally liable for the debts of the borrower. This means that the bank/trade supplier can come after you as guarantor, without having taken any steps to chase the borrower first. In fact, the bank can choose to make demand on you and never make demand from the borrower at all.

- **What borrowing is captured by the guarantee?**

Generally, all amounts owing now or in future by the borrower to the bank/trade supplier will be captured by your guarantee. You are even responsible for:

- borrowing that you may not/do not know about (whether existing now or in future);
- any obligations that the borrower has itself guaranteed to the bank/trade supplier. For example, if Jim guarantees the obligations of Fix It Limited to Placemakers, and Fix It Limited has itself guaranteed the obligations of Its Still Broken Limited to Placemakers, Jim will be on the hook to Placemakers for all of Fix It Limited and Its Still Broken Limited's obligations.

- **What happens if there are multiple guarantors?**

Each guarantor is jointly and severally liable to the bank/trade supplier. The bank/trade supplier can choose to demand payment from any of the guarantors, some of them or all of them. If the bank makes demand on you, you must comply with that demand in full and you can then make your own demand on the other guarantors (and the borrower) to recover pro-rata portions from them.

- **What happens if the other people named as guarantors didn't actually sign their guarantees?**

It depends on what your guarantee says. Some guarantees will only be binding if all of the persons named as guarantors actually signed – the argument being it's unfair for one person to be liable as guarantor, when they only provided the guarantee because they thought someone else was doing it too. However, some guarantees will be binding regardless of whether all named guarantors actually signed. So make sure that if several people have been asked to provide guarantees, they all actually do so – otherwise you could be left carrying the can alone.

- **Do I have to sign the guarantee?**

No, you are never legally required to sign a guarantee. However, practically, often lenders/trade suppliers will not advance credit until a guarantee is signed.

- **Will providing a guarantee affect my own ability to borrow?**

Yes, responsible lenders will take into account the value (or potential value) of any guarantees you have provided when considering any loan application you make. As a result, providing a guarantee will reduce the amount that you personally are able to borrow (for example, reducing the amount you could borrow to buy a car or house).

- **I've signed a guarantee, but the bank/trade supplier has agreed to release some other security given by the Borrower without asking me. Can it do that? Am I off the hook now?**

Unfortunately, your guarantee is not affected by the bank/trade supplier doing anything that might increase the risk of your guarantee being called upon or the amount you may be required to pay (unless you've given a limited guarantee). The bank/trade supplier can release the borrower from liability, release or change any existing security, release another or all other guarantors, lend more money, agree to moving to interest-only repayments for a period and so on, all without your permission.

- **I've just noticed the trade account I signed includes a guarantee at the bottom, that I signed without realising what it means. Am I bound by that?**

Most trade accounts include guarantee provisions like this and unfortunately, often clients aren't aware that what they have signed is actually a guarantee. The law does require people to be given clear warning and have the key features of the guarantee explained to them before they sign a guarantee. Whether the guarantee will be binding will depend on a range of factors, which we can discuss with you.

- **How do I get out of my guarantee?**

You can inform the bank/trade supplier that you no longer wish to guarantee future lending. However, you will still remain liable for all existing debt/obligations up until that date. The bank/trade supplier may also immediately call up all existing debt, on the basis that it is no longer satisfied that there is sufficient security in place without your guarantee. Generally though, you will only be released from your guarantee when all existing debt has been repaid or the bank/trade supplier is satisfied that a suitable alternative security arrangement has been put in place (i.e. a replacement guarantor or mortgage).

- **Should I provide a guarantee?**

Providing a guarantee is a serious decision and should not be done without careful thought. You need to consider whether signing the guarantee is in your personal best interests, and often, it will not be. However, other times guarantees are a necessary means of providing security that will unlock the ability to obtain borrowing essential to operation and growth of your business.

**If you need help to understand your obligations around signing a guarantee and what to be aware of before you sign, get in touch so we can help.**

**Contact:**

**E**     [helpdesk@tradielaw.nz](mailto:helpdesk@tradielaw.nz)

**W**     <https://tradielaw.co.nz/tradie-law/contact/>

**One of our team will be in touch to assist you within 24 hours.**