

Directors' guarantees – an unexpected downside from the credit crunch

Businesses experiencing cash flow problems may be unable to cope when their Bank demands repayment of overdraft facilities or loans which default. This can lead to companies passing into administration and the sale of assets of the business, often at values far below a realistic and reasonable level.

Banks then seek to recover the inevitable shortfall from directors under their personal guarantees.

If administration for the company or LLP is unavoidable what can be done to avoid dire personal consequences?

Being aware of the Bank's agenda is of critical importance. The Bank seeks a disposal of assets in order to recover as much of its open position in as short a timeframe as is possible. The fact that the assets of the company may be sold at an under-value is usually a lesser concern for the Bank.

The typical scenario arises where a Bank has taken a charge over property or a business. This affords directors some comfort when agreeing to give guarantees because they believe that the assets should meet any liability to the Bank. A guarantor is entitled to enter into a guarantee in the expectation that if the Bank chooses to realise its security the Bank will do so properly to realise the market value of the property charged. This will reduce the liability of the guarantor unless the terms of the guarantee clearly indicate otherwise.

Recent case law has made it clear that Banks and Administrators are obliged to sell for a reasonable price thereby ensuring demands under guarantees are only made for sums which properly reflect the personal responsibility of directors.

Some of the signs to watch out for are Banks:

Pre-administration

- Telling you who can be hired or fired
- Requiring you to close divisions the Bank considers unsustainable in your present trading conditions

- Demanding you pay the Bank excessively high amounts of money each day or week to reduce the overdraft
- Refusing to allow you to decide what payments should be made to creditors
- Involving insolvency practitioners (IPs) in reporting to the Bank about the performance of the business
- Requiring you to appoint those same IPs as Administrators

Post administration

- Collaborating with Administrators to dispose of the company's principal assets on the day of administration at a knock down price
- Failing to ensure assets are realised in a sensible manner in the appropriate market place.

We are finding that the “pre-pack” administration is particularly prone to cause problems for directors. Because Banks are under pressure to improve their liquidity fast. Where customers are underperforming they do so by forcing realisation of assets through administration. This can lead to improper demands under guarantees.

By taking advice early it is possible to manage financial difficulties in such a way as to minimise potential personal claims against the director.

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