

CONSTRUCTION SECURITY AND PERSONAL GUARANTEES

PricewaterhouseCoopers

Personal guarantees can expose building contractors to the risk of great personal financial hardship while ironically the contractor's business may be unaffected.

In the wake of the HIH and Onetel insolvencies, the commercial world has been paying significant attention to the ability of organisations to honour all of their contractual obligations.

The construction industry is particularly familiar with concerned 'paying' parties worrying whether 'doing' parties will be able to complete their contracts. Consequently, requiring a builder or supplier to provide security against the possibility of his not being able to finish a job is commonplace.

Contractors are all familiar with forms of securities such as retention, performance bonds, insurance bonds, bank guarantees, security deposits, parent company guarantees and insurance. In the residential sector, the home owners' warranty insurance required by the *Home Building Act 1989* is probably the best example of insurance designed purely to secure a builder's performance and building work.

The building contract usually sets out the obligation to provide one or more of these forms of security and the right of the principal or owner to use it.

PERSONAL GUARANTEES

More recently, it has become increasingly common for owners to require personal guarantees from building contractors in addition to one of the other forms of security listed above.

A personal guarantee is an undertaking, usually given by one

or more of the directors or shareholders of the company which is the building contractor, that if the building contractor cannot complete the works, any loss that results from that failure will be met by the guarantor(s).

A personal guarantee is a separate contract which is collateral to the construction contract, but which operates independently. Many personal guarantees actually make the guarantor liable for default under the building contract by the building contractor.

The contract of guarantee is made directly between the owner and the guarantor and usually makes the guarantor personally liable for the losses he/she is guaranteeing. In practical terms this means that the guarantor is putting his or her personal assets up as a security against the building contractor's performance of the works.

CAREFUL WORDING REQUIRED

Most standard form contracts do not make provision for personal guarantees in addition to other forms of security. Accordingly, unless the guarantor insists that either the guarantee itself or the building contract sets out carefully the circumstances in which the personal guarantee can be called in, the guarantor may be distressed to discover that the guarantee is called before any other security has been exhausted. This may come as a rude shock to a guarantor who has assumed that the personal guarantee is a 'last ditch' remedy for the building owner.

Guarantors should insist that both the guarantee and the building contract itself state clearly the circumstances in which the personal guarantee may be called. Ideally it should not be possible to call a personal guarantee until all other forms of security have been exhausted, and then only with the giving of sufficient written notice.

Building contractors and guarantors should not be shy about insisting on this being written into the contract and the guarantee; after all, such provisions are standard for other forms of security in most building contracts. Guarantors should be aware that a verbal assurance by the owner that he will not call on the personal guarantee except as a last resort is unlikely to provide protection if the matter should later become before a court.

CONCLUSION

Builders should be aware that a personal guarantee means that the guarantor's assets, including his/her home, may be at risk when he/she agrees to provide this kind of security. Builders should seek legal and financial advice on alternative means of providing security, and they should encourage the owner to be satisfied with these means. Ultimately, if the company's balance sheet does not reflect assets of any significant worth, a personal guarantee may still be required. If this is the case, guarantors should insist that both the building contract and the personal guarantee state clearly the circumstances in which the guarantee may be called, so that it is clear to all that it really is a 'last resort'.

This article first appeared in PricewaterhouseCoopers' *Construct* bulletin (December 2001) and is reprinted with permission.
