

Personal Loan Guarantees (*Entrepreneur Magazine* – September 16, 2002)

Many business owners have concerns regarding how a personal guarantee works when doing a funding deal. It's very important that you seek expert legal advice about the specific laws of your city and state, as this article simply aims to provide an overview of the basic issues related to a personal guarantee.

There are several details to consider, but the main line of reasoning begins with the words "personal" and "guarantee." These words mean what they say, so before putting their signatures on financial documents for the company, entrepreneurs need to consider very carefully the future potential impact these two words could have. The main concern? Liability for the obligation agreed to by the firm.

The first word, "personal," refers to you, the individual, the owner of the company. It doesn't refer to your board members, your senior managers or any of your employees. It does not allude to the tax professional or attorney who provides business advice. In the case of a proprietorship, the owner/entrepreneur and the business are one and the same in the eyes of the law. When Mary Owner signs for Mary Owner Services, the line between personal and business is obviously not there. But even in the case of a dba, an LLC or a corporation, the line can also be very hard to find because it's not the company's name on the signature line--it's your name out there all by itself.

The second word, "guarantee," means "a pledge or assurance." Therefore, the term "personal guarantee" translates to you providing your own individual

pledge or assurance for an obligation. Depending on the exact wording of your financing documents, you are personally pledging that you will make good on the obligation, even if your form of business organization provides limited liability protection under the law.

Businesses can be set up under different legal forms. Some of these provide limited liability inherent in the structure to protect and separate personal assets from those of the company. Others, however, expose owners to unlimited liability, where personal assets are unprotected from claims made against the company.

For example, when Mary Owner operates her services company as Big-Time Benefits (the dba for Mary Owner), there is no liability protection inherent in the company's organizational structure. (A dba is essentially a proprietorship with a different operating name than the owner's name.) So even though the dba appears on certain contractual documents, that business is still one and the same with Mary Owner.

In the case of the partnership Big Time Benefits LP, Mary and her partners (including general partners, who participate in the daily management of the firm, and limited partners, who are simply passive investors without any managerial oversight) may operate the firm under that company name, but she and the general partners are still one and the same with the business. The limited partners do have specific legal protection from liability, but consult your attorney about the specific laws in your city and state.

In the case of a corporation (depending on the form chosen and the state in which incorporation is originated), the shareholders are the owners of the company Big Time Benefits Inc., but the firm itself is recognized as an independent, tax-paying entity under most laws. Mary Owner may be a

majority shareholder in the company, but the corporate organizational structure does provide a level of limited liability protection for her and the other shareholders. Typically, the firm's name is on all the legal documents, including employment agreements, financing contracts and the like. In the event of a failure to make good on a certain obligation, the liability belongs to the corporation.

Sometimes, however, a newly launched firm may be required to have a personal guarantee on certain loans, credit cards or other debt obligations. The general rule of thumb is that even though the corporation provides liability protection to shareholders, any individual who provides a personal guarantee--even if that person is a shareholder--has contractually agreed to make good on the obligation in the event the corporation cannot. Because the personal guarantee is like a co-signer on a loan, the creditor will come to this person once it's determined that the primary borrower cannot meet the financial obligation. This could pertain to an equipment lease, a partnership agreement with a person or another firm, a real estate lease with a landlord, or various types of loans.

Providing the personal guarantee is generally viewed as a separate issue from whether or not the individual has limited liability within the company's organizational structure. The best approach is to make sure any company obligations are truly the company's concern alone and that your individual name is not included in the documentation. So when a personal guarantee is made, be prepared to cover that obligation in the event the business cannot.