

Avoiding or Limiting Personal Liability For Your Company's Debts

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Entrepreneurs operate their businesses through corporations or limited liability companies because they do not want to be personally responsible for the business' debts. Thus, when one contracting party is a corporation or LLC the other party may attempt to obtain personal guarantees from the corporate stockholders or LLC members (Owners).

Personal guarantees pose serious risks to business owners who become "Guarantors." The limited liability protection of their business entity is lost with respect to the guaranteed obligations. If the company defaults, the Guarantor's personal assets are vulnerable to a bank or other creditor seeking to enforce the guaranteed obligation. Some lenders will require the guarantor's spouse to also sign the personal guarantee, so even if the guarantor's house or retirement accounts are in the spouse's name, they could be at risk, too. This exposure exists even if the business files for bankruptcy protection because the Guarantor is separate and distinct from the entity. In addition, if there are two or more Guarantors, they will usually be jointly and severally liable, meaning that any signer can be held responsible for 100 percent of the loan deficiency, regardless of their stake in the business. This could be of particular importance when there is a wide disparity in the assets of the owners. Also, a creditor may pursue co-signers which can strain or ruin family or business relationships.

Let's assume that Victor's Vacuum Corp. (VVC) applies for a bank loan. The bank will probably require Victor, who owns all of VVC's stock, and perhaps Valerie, his wife, to personally guarantee the loan. Victor doesn't want to sign the personal guarantee, but needs the loan for his company. What are his options?

In today's lending environment, which has seen loan defaults by businesses once thought to be "rock-solid," it is unlikely that Victor will convince the bank to waive the personal guarantee. Victor might consider putting-up collateral, making a large deposit at the bank or

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referring the bank a sizeable amount of new business. Even if VVC's relationship manager were willing to recommend that the bank waive the guarantee, bank policy or applicable regulations such as those of the U.S. Small Business Administration may require the guarantee.

Victor might, however, have better luck negotiating limitations on the guarantee, such as:

- Capping the guarantee at a specified dollar amount or percentage of the debt (making sure that the cap covers principal, interest and collection fees).
- Making only certain of his personal assets subject to the guarantee.
- Reducing or terminating the guarantee if VVC meets all of its obligations for a specified period or when the loan principal is reduced to a specified level (on the theory that VVC would have established its ability to pay back the loan).
- Reducing or terminating the guarantee when cash flows meet certain levels (for example, if the loan's purpose was to enable VVC to increase earnings to a specified level and that is achieved).
- Making the guarantee enforceable only in specified circumstances, e.g., guarantee applies

only in cases of gross negligence or fraud.

- If Victor's personal assets are sufficient security, avoiding Valerie signing the guarantee.
- Reducing the loan amount or term to limit exposure under the personal guarantee.

In addition, Victor might attempt to negotiate more favorable covenants in the loan documents to reduce the potential of a default based on a breach of covenant even if payments under the loan are current. Victor should also be careful to require that any new owners entering the business sign guarantees to relieve some of his financial liability or that if he were to sell his interest in the business. In addition, if the form of personal guarantee the bank requests extend the guarantee to future loans, he should endeavor to restrict it to the current loan.

Commercial leases are another situation in which personal guarantees are often an issue. For example, an office lease is being negotiated between HB LLC, and the landlord. The landlord has asked that Homer and Bart each personally guarantee HB LLC's obligations under the lease.

First, note that unlike Victor's position with the bank, thanks to the weakened office rental market, Homer and Bart probably have

Small Business continued on page 29

And in September, we held the County Executive debate, which I will say was a "spirited conversation" that ensured that the candidates, and our members, are focused on the key issues impacting the business community as we prepared for that important election.

As co-chair of the Tappan Zee Bridge futures task force, I continue to advocate for a new bridge, with a mass transit component to connect the region north to south and east to west.

It seems that all we hear about these days are challenges, but believe me, the Business Council is listening to our members, and we hear success stories. Many of our members found opportunity in the current economy, and have created new strategic alliances with other Business Council members, positioning themselves to be stronger and more resilient.

In fact, we've welcomed about 200 new businesses to the Council this year. Those businesses are diverse in every way: they represent more than 110 different industries, from attorneys and health care providers to not-for profits and commercial real estate developers. They range from solo entrepreneurs to Westchester's largest employers, with thousands of employees. And they hail from all over the county... from Yonkers to Yorktown Heights - and across the region, including New York City, Fairfield County, CT and the Mid-Hudson Valley.

While it's always good to know where you came from, I believe it's more important to know where you're going. I've mentioned the work we've done to learn about what our members need, and I want you to know that we're acting on what we learn. For starters, we've begun to integrate new media and Internet networking opportunities into the work we're doing.

As we close 2009, and the final pages of Commerce Magazine (stay tuned for an exciting new publication in 2010!), rest assured that next year, and every year, the Business Council is constantly working to create new opportunities for you to get more involved, meet new people and expand your network of business connections. I encourage you to stay active and engaged.

I look forward to seeing you and hearing from you in what I hope will be a prosperous new year.



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continued from page 27

significant leverage to negotiate more favorable lease terms than they might otherwise obtain. They may be able to eliminate the personal guarantees through arguments such as the following:

- HB LLC is financially strong, has an impeccable credit rating, strong financial statements, a significant history of growth and has weathered prior economic downturns.

- Waiver of the guarantees is warranted by the circumstances, e.g., HB LLC will invest significant cash for improvements to a run-down property.

In the alternative, they may be able to negotiate meaningful limitations on the guarantees, such as the following:

- Waiver or reduction of the guarantee if specified financial criteria are met, e.g., sales and expenses are at certain levels. This would require that the landlord have periodic access to HB LLC's financial statements.

- Waiver or reduction of the guarantee after a specified period of time so long as all rent and other amounts due under the lease are current. The likelihood of business failure and default under the lease is usually most significant during the first few years of the lease term.

- A "Good Guy" Guarantee, a form of limited personal guaranty under which the guarantor's liability ends when the tenant has vacated the premises and surrendered the keys and possession to the landlord. Compared to an unlimited guarantee, a Good Guy Guarantee is easier for the landlord to obtain because it gives the guarantor an escape route. Similarly, it is harder for the tenant to refuse because it motivates the tenant to be a "good guy" and vacate the premises, thereby protecting the guarantor who is usually an owner or company affiliated with the tenant.

- Limit liability under the guarantee to a specified number of months of rent on the theory that the specified period should be sufficient for the landlord to re-rent the premises.

- Limit liability under the guarantee to rent or other specific liabilities under the lease, such as the landlord's expenditures for tenant improvements (which would reduce on a sliding scale as the expenditures are amortized);

In addition, an over-leveraged landlord might be enticed to waive or limit the personal guarantee by the offer of a cash payment or higher rent or security. Or, Homer and Bart might consider negotiating a shorter-term lease with an option to renew to reduce potential liability under the guarantee. However, this may be relatively

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more expensive because the shorter term would require the landlord to re-rent the premises sooner and amortize the cost of any improvements over the shorter term. In addition, if HB LLC is also seeking a business loan, the lender will require the lease term be not less than the loan term.

Bank loans and commercial leases are only two of the numerous situations in which personal guarantees may be requested or demanded. Others include extension of credit by a vendor, purchase of a business by a newly-formed corporation or LLC where a portion of the purchase price is to be paid over time and, on a personal level, parents being asked to guarantee a child's obligations.

The principals set forth in the context of each of the two examples cited above also apply to the other. Moreover, the techniques can be combined or modified as appropriate to particular circumstances.

Whatever the context, you should think very carefully before signing a personal guarantee. First and foremost, don't even consider signing unless you are virtually certain that the obligor will meet its obligations. Second, if possible, use whatever leverage circumstances may yield to avoid the guarantee. Next, if you feel you need to sign, seek to limit your exposure.

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