

Food for Thought

The Matter of Personal Liability for Restaurant Debt

By MARK A. TANNER, Esq.

Restaurants in Massachusetts can be organized to do business in many different corporate forms, including sole proprietorships, partnerships, corporations, and limited-liability companies. When restaurateurs choose to operate their business using a corporate form such as an LLC, it is often with the belief that, should the business fail to be profitable or close altogether, the owners will not be personally liable for the restaurant's debts.

Unfortunately, even if the restaurant is operated as a corporate entity, there are instances where the restaurant's owners may be liable for debts incurred in the operation of their business. One frequently occurring example is when a restaurant's owner signs a so-called 'personal guarantee.' Often, the personal guarantee is found on the last page of a form contract, lease, or credit application, and it is not completely read or understood by the person signing the document.

In most instances, if the business defaults on its obligations, a personal guarantee contractually obligates its signor to pay from his or her own assets the obligations of the business to the creditor holding the personal guarantee. Frequently, personal guarantees are written so they do not require that the creditor initially look to business assets to satisfy the restaurant's debt, but instead allow the creditor to immediately pursue the guarantor for payment.

Complications may also arise where there is more than one principal or owner, and therefore more than one guarantor of the restaurant's debt. Personal guar-

antees from multiple individuals generally allow a creditor to seek payment for the entire debt from any or all of the principals, and often do not require that the principals pay their proportional 'share' of the debt. Rather, the creditor may collect all of the outstanding debt from the guarantor they believe to be most solvent.

weigh the risks, or the benefits are marginal, it may be in the restaurateur's interest to select a vendor that does not require a personal guarantee.

- **Read and understand the guarantee.** If the analysis runs in favor of the supplier requiring the guarantee, restaurateurs should be certain to read and understand

Frequently, personal guarantees are written so they do not require that the creditor initially look to business assets to satisfy the restaurant's debt, but instead allow the creditor to immediately pursue the guarantor for payment.

Unless the restaurant is well-financed, or the principals have a proven track record of success in the industry, it is likely that lending institutions such as banks and institutional suppliers will seek personal guarantees from the restaurant's principals. When faced with the possibility of signing a personal guarantee, there are a number of things restaurateurs should consider.

- **Decide if you really need this vendor or lender.** Restaurateurs should initially determine whether there are other suppliers of this good or service that do not require a personal guarantee. If there are, an analysis of the competing providers should be conducted to determine whether the benefits provided by the entity requiring the personal guarantee outweigh the risks associated with personal liability. If the benefits do not out-

weigh the risks, or the benefits are marginal, it may be in the restaurateur's interest to select a vendor that does not require a personal guarantee. For example, among other things, it is important to understand whether the guarantee requires that the creditor initially look to corporate assets to satisfy the restaurant's debt before seeking liability on the guarantee. Similarly, restaurateurs should also know whether they are guaranteeing the payment of the creditor's attorneys' fees and costs, should enforcement of the guarantee become necessary.

- **Try to negotiate the terms of the guarantee.** If a potential supplier or creditor has a form personal guarantee in its agreement, restaurateurs should ask that the personal guarantee section be deleted from the agreement. Depending on the size of the supplier, its business requirements, and its perception of your business, some suppliers are will-

ing to delete personal guarantees entirely in order to gain the restaurant's business. Alternatively, if a supplier is not willing to delete the personal guarantee entirely, many suppliers are willing to negotiate the length and other conditions of the guarantee.

- **Ensure that all principals sign a personal guarantee.** If there is more than one principal in the restaurant, and you are being asked to personally guarantee the restaurant's debt, in most instances you should require that each principal of the restaurant sign a personal guarantee as a condition of your signature. This requirement, along with appropriate provisions in the restaurant's operating agreement or bylaws, will ensure that all principals are equally liable for the debt and that each principal has recourse against the other in the event that a creditor seeks recovery on the personal guarantee from only one principal.

- **Place a homestead on your principal residence.** While most commercial-lending institutions such as banks require physical collateral such as a mortgage on real property, most purveyors or suppliers do not. Since there is generally no mortgage securing the debt owed to the purveyor or supplier, Mass. General Laws may allow you to protect a substantial amount of equity in your principal residence. Placing a homestead on your principal residence will, in many instances, protect the equity you have in your home, even if you previously signed a personal guarantee.

Restaurateurs doing business as limited-liability entities, such as corporations or LLCs, should

think long and hard before guaranteeing the debt of their business, because doing so effectively strips many of the protections afforded by those entities. Fortunately, if a restaurateur seeks advice from an attorney, accountant, or other professional knowledgeable in this area before

signing a personal guarantee or any legal contract, he or she may be able to avoid many of the pitfalls which often accompany such guarantees.❖

Mark A. Tanner is an attorney in the Northampton office of the law firm of Bacon Wilson, P.C.

Prior to practicing law, he graduated from the Hotel, Restaurant and Travel Administration Program at UMass Amherst and the MBA program at the University of Colorado. He managed corporate restaurants for Houlihan's and Ruby Tuesday in Massachusetts, New Jersey, and

Colorado. Tanner currently advises numerous restaurateurs and other businesses in litigation and business planning matters. This article is provided for informational purposes only, does not constitute legal advice, and should not supplement independent legal advice.