

Enforcement of loan guarantees to change under new laws

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New amendments to the Civil and Commercial Code will change the way loan guarantees are enforced in Thailand. Under the changes, which are due to take effect on Feb 11, guarantors will benefit from increased protection, as contracts imposing joint liability between a debtor and a guarantor will be void.

This change would, at first glance, appear to suggest that creditors will be forced to pursue debtors before pursuing guarantors. In reality, however, creditors will still have options to pursue guarantors before debtors under the new law.

Guarantees are contractual arrangements whereby a guarantor agrees to be responsible for another person's performance.

For example, when a creditor provides a loan to a debtor and the debtor fails to repay the loan, the guarantor is required to pay the creditor. If the guarantor does not voluntarily perform, the creditor can enforce the guarantee. This normally requires filing a civil lawsuit.

Under the new amendments, when a debtor defaults, a creditor is required to notify the debtor's guarantor within 60 days of the default.

If the creditor fails to give such notice, it cannot recover interest, costs and expenses from the guarantor that were incurred after the 60 days. The present law, in comparison, does not contain any notice requirements.

Furthermore, under the new law, the creditor cannot demand the guarantor to immediately pay the debt until the notice reaches the guarantor. The present law allows creditors to immediately demand performance from the guarantor when the debtor defaults.

Another key change involves a guarantor's liability for the debt. The new law states that contracts imposing joint liability between a debtor and guarantor will be void. The present law contains no such prohibition.

Under the present law, if a debtor defaults and the guarantor fails to voluntarily satisfy the debt, the creditor has the option to enforce the guarantee by filing a claim against the guarantor. Only the guarantor — and not the debtor — would be answerable for the debt. Such joint liability is especially useful when the debtor has no assets, which is often the reason why a guarantee arrangement is made in the first place.

Local lenders are not pleased with the changes to joint liability. Thai banking industry executives have expressed concern that a creditor would have to seek recovery from the debtor before it can enforce the guarantee. This would incur additional expenses and time to recover the debt, since two related lawsuits would be required where only one is necessary under the present law.

Despite these concerns, however, guarantors are not quite off the hook. Options still exist that allow creditors to directly enforce guarantees instead of first having to pursue debtors.

Guarantee arrangements generally involve two distinct contractual relationships. One relationship is between a creditor and debtor. The other is between a creditor and a guarantor. A court views each relationship as separate, even if all of the parties were signatories to the same contract.

Since the parties' relationships are legally separate and distinct from each other, a creditor would still be able to pursue a claim exclusively against the guarantor without having to sue the debtor first. The new law's prohibition on joint liability contract provisions does not prevent this.

Moreover, under Thai civil procedure laws, a court judgement is binding only on the parties in the case. Therefore, if a creditor sues a guarantor only, the guarantor cannot compel the creditor to enforce the debt against the debtor first.

If the guarantor wants the debtor to bear liability for the debt, the guarantor would have to ask the court to bring the debtor into the case as a co-defendant. The guarantor's failure to do so would not affect the creditor's right to enforce the guarantee.

A creditor may also consider suing both the guarantor and debtor simultaneously, as part of the same case. If the creditor obtains a judgement against both the guarantor and the debtor, the court would order the debtor to pay first if the guarantor can prove that the debtor has assets and enforcement is not difficult. Should the creditor fail to recover against the debtor's asset, it can then seek to enforce the judgement against the guarantor.

A guarantor would be protected from paying a creditor first if the contract language in the applicable agreement states that the creditor must exhaust all remedies against the debtor before enforcing the guarantee. Any initial lawsuit against the guarantor would likely be unsuccessful if the parties' contract is clear in this regard.

In sum, the new legal framework makes enforcement of guarantees more burdensome for creditors. However, guarantors would argue that the amendments provide greater fairness. In any case, creditors, debtors and guarantors should all consider the legal and business issues raised by the new laws and act accordingly when setting up and enforcing guarantee arrangements.