

In certain cases, where there is a primary and secondary liability of two persons for the same debt, they will stand in the relationship to each other of principal and surety even though there is no express contract of suretyship between them.³ Thus the acceptor of an accommodation bill of exchange is a surety for the payment by the drawer, and the maker of an accommodation note is in the position of a surety, with all the surety's rights.⁴ However, the relationship of principal and surety will not always arise in such circumstances. For instance, if property which was subject to a mortgage has been sold and the mortgagor remains under a liability to the mortgagee, he does not become a surety for the purchaser: *Re Errington* [1894] 1 Q.B. 11. Similarly, if a person assigns a lease and the assignee covenants to indemnify him against liability for breaches of covenants in the lease, the assignee thereby undertakes a primary liability as between himself and the assignor, but the assignor does not become a surety for the assignee.⁵ A transferor of shares does not become the guarantor of the transferee, though he may be liable by statute to pay calls if the transferee does not.⁶

Contracts of suretyship

1-003 Contracts of suretyship fall into two main categories: contracts of guarantee and contracts of indemnity. Guarantees and indemnities have many similar characteristics, and similar rights and duties arise between the parties. Consequently, it is not unusual to find the term "guarantee" used loosely to describe a contract which is in reality an indemnity (and vice versa). However, despite the similarities, it is often important to ascertain into which of these two categories a particular agreement falls. This can have a significant bearing on the enforceability of the contract against the surety, and the extent and nature of his liability, in two particular respects.

First, contracts of guarantee, but not contracts of indemnity, are prima facie unenforceable by the creditor if they do not comply with the requirements of s.4 of the Statute of Frauds 1677.⁷ Secondly, the liability of a guarantor is normally co-extensive with the liability of the principal. Therefore, if the obligation of the principal to the creditor is unenforceable, or has been discharged, the liability of the surety may depend on whether the contract is a guarantee or an indemnity.⁸

In addition to guarantees and indemnities, there are various types of commercial contract, such as performance bonds (sometimes called "performance guarantees"), export credit guarantees and carnets, which may be described as contracts of suretyship, or which are very closely related to them, and yet have special distinct characteristics which it is more appropriate to consider independently.

³ See *Duncan Fox & Co v North and South Wales Bank* (1880-81) L.R. 6 App. Cas. 1 at 11, discussed in para.1-006.

⁴ See, e.g. *Re Acraman, Ex parte Webster* (1847) De G. 414; *Bailey v Edwards* (1864) 4 B. & S. 761; *Yonge, Ex parte* (1814) 3 V. & B. 31 at 40, per Lord Eldon L.C.

⁵ *Baynton v Morgan* (1888) L.R. 21 Q.B.D. 101; see also *Allied London Investments Ltd v Hambro Life Assurance Plc* (1984) 269 E.G. 41; *Selous Street Properties v Oronel Fabrics* (1984) 270 E.G. 743.

⁶ See *Gore-Browne on Companies*, Vol.2, Ch.23, para 8; *Roberts v Crowe* (1872) L.R. 7 C.P. 629; *Contract Corp* (1871) L.R. 12 Eq. 1; *Helbert v Banner* (1871) L.R. 5 H.L. 28.

⁷ See Ch.3.

⁸ See Chs 6 and 9.

These will therefore be dealt with in detail in Chs 14 to 16 of this book. Chapter 18 will deal with the special considerations which may apply to contracts of guarantee in the context of the relationships between landlord and tenant and their respective assignees.

Contracts of guarantee

Definition

A contract of guarantee, in the true sense, is a contract whereby the surety (or guarantor) promises the creditor to be responsible, in addition to the principal, for the due performance by the principal of his existing or future obligations to the creditor, if the principal fails to perform those obligations. In *Wardens and Commonalty of the Mystery of Mercers of the City of London v New Hampshire Insurance Company* (1991) 3 J.I.B.F.L. 144, Phillips J. cited with approval the following definition of a guarantee which is given in *Halsbury's Laws of England* (5th edn, 2008), para.1013:

"A guarantee is an accessory contract by which the promisor undertakes to be answerable to the promisee for the debt, default or miscarriage of another person,⁹ whose primary liability to the promisee must exist or be contemplated."¹⁰

In *Vossloh AG v Alpha Trains (UK) Ltd* [2010] EWHC 2443 (Ch), [2011] 2 All E.R. (Comm) 307, Sir William Blackburne gave the following succinct definition at [23]:

"A contract of guarantee, in the true sense, is a contract whereby the surety (the guarantor) promises the creditor to be responsible for the due performance by the principal of his existing or future obligations to the creditor if the principal fails to perform them or any of them."

Although the expressions "creditor" and "debtor" are often used to denote the underlying obligee and obligor, the liability which is guaranteed may consist of performance of some obligation other than the payment of a debt, and does not have to be a contractual liability, although it usually is.

The liability of the guarantor has been defined as a liability not only to perform himself if the principal fails to do so, but to procure (or "see to it") that the principal performs his obligations.¹¹ However, given that in practice the guarantor is rarely in a position to compel the principal to perform his obligations, it is probably more accurate to describe the guarantor's promise as a promise that the obli-

⁹ The words "debt, default or miscarriage" are taken from the Statute of Frauds (1677) s.4, see Ch.3.
¹⁰ For a list of other definitions of guarantee that have been given in textbooks and treatises from time to time, see *Re Conley* [1938] 2 All E.R. 127 at 130-131.

¹¹ *Moschi v Lep Air Services Ltd* [1973] A.C. 331 especially per Lord Diplock at 348-349. Cf. *General Produce Co v United Bank* [1979] 2 Lloyd's Rep. 255, where Lloyd L.J. at 258 refers to two classes of guarantee: a promise which becomes effective if the debtor fails to perform his obligations; and a promise that the debtor will perform his obligations.

unvaried agreement. Therefore there was a mismatch between the certificate and the relevant liability. The Chancellor, Sir Andrew Morritt, gave the argument that cl.3.4 turned the contract into a performance bond short shrift. He pointed out that under the terms of the guarantee in *North Shore Ventures*, the Guarantors had agreed to pay as primary obligors the actual indebtedness of the principal to North Shore, and distinguished *Van der Merwe v IIG* on the basis that the terms of the contract in that case were materially different, because they referred to sums that were “expressed to be due, owing or payable”. Further, the Chancellor’s view (expressed at [48]) was that the certificate was conclusive evidence only of the “amount” due, and this could not be conclusive either of the fact of the variation or of its legal effect. The former would seem to be outside any reasonable limit as to what is meant by “amount” and the latter is a question of law which is not a matter for evidence, whether conclusive or otherwise. However, he said that he preferred not to decide the case on the basis that the certificate cannot be conclusive as to the existence and effect of the variation because of the dictum of the High Court of Australia in *Dobbs v National Bank of Australasia* (1935) 53 C.L.R. 643 to which Tomlinson L.J. referred in his judgment, and because of his conclusion on the “manifest error” point.

Although she said she agreed with the Chancellor’s judgment, Smith L.J. did not express any clear view on this issue, but her judgment appears to assume (in the last sentence of [59]) that the only answer to North Shore’s reliance on cl.3.4 was that the certificate was “manifestly incorrect”. The third member of the court, Tomlinson L.J., was the only one who was prepared to expressly articulate the view that a conclusive evidence clause may have the effect of transforming a straightforward guarantee which is not phrased in terms of a performance bond into something analogous to one.⁴⁷ He said he was reluctant to share the Chancellor’s view at [48] because the High Court of Australia, in the case of *Dobbs v National Bank of Australasia* had suggested that a clause in similar form to the one in the guarantee did make the certificate conclusive of the legal existence of the debt. The three judges delivering the majority judgment said at 651:

“It is not easy to see how the amount can be certified unless the certifier forms some conclusion as to what items ought to be taken into account, and such a conclusion goes to the existence of the indebtedness. Perhaps such a clause should not be interpreted as covering all grounds which go to the validity of a debt – for instance illegality . . . but the manifest effect of the clause was to provide a ready means of establishing the existence and amount of the guaranteed debt and avoiding an inquiry upon legal evidence into the debits going to make up the indebtedness. The clause means what it says.”⁴⁸

⁴⁷ The view that a conclusive evidence clause could have this “extraordinary effect” was first aired by the authors J. O’Donovan and J. Phillips, of *The Modern Contract of Guarantee*, and the likely ramifications for the surety are strongly criticised by them in para 5–151 of the 2nd English Edition (2010) and in a passage quoted by Waller L.J. in *IIG v Van Der Merwe*.

⁴⁸ Likewise, Lewison J. at first instance in *IIG v Van Der Merwe* said that a certificate of an amount that is “due” and “payable” must certify liability, because a sum can be neither due nor payable unless there is a liability to pay it. Whilst there is logic in that approach, it ignores the function that such clauses are designed to serve.

As Tomlinson L.J. stated at [68] of the judgment in *North Shore Ventures*, the ambit and effect of a clause such as cl.3.4 is a question of potentially wide importance. It is regrettable, therefore, that the Court of Appeal did not take the opportunity to dispose of the argument once and for all and make it clear that a clause which refers to a certificate of the amount due or payable as being “conclusive evidence”, is normally to be construed as meaning that it is evidence only of quantum and not of liability, and that it would take explicit wording to make the liability of the surety to pay conditioned upon a certificate alone,⁴⁹ or to make the creditor the sole arbiter of any relevant facts pertaining to the principal’s or surety’s liability or of whether such a liability has arisen.⁵⁰

The reasoning of the High Court of Australia is, with the greatest respect, flawed, and there is no obligation on the courts of England and Wales to follow it.⁵¹ Of course the certifier must form a conclusion as to how to calculate the amount of the indebtedness, and what ingredients are to go into that calculation, but that does not mean that he is necessarily deciding, let alone deciding conclusively, that the principal is legally liable to make that payment, even if the certificate purports to state the amount that is “due” or “payable”. In most cases the person carrying out the computation is likely to be operating on an assumption of liability, without turning his mind to the question whether the assumption is justified. Evidence, as the Chancellor pointed out in *North Shore Ventures*, can only be evidence of facts (e.g. the fact that certain advances were made on certain dates, or the fact that the principal has not paid the creditor a particular amount on a particular date) and not of the legal consequences to be derived from those facts. Moreover, there is a world of difference between parties wishing to avoid an inquiry into all the debits from a borrower’s account, and their wishing to avoid an inquiry into whether he has defaulted on his contractual obligations in the first place, or an inquiry into whether those obligations have been varied, or whether he has any set-off or other defence to the creditor’s claim. Any concern about avoiding an inquiry into the way in which the loss is computed can be met by making the certificate conclusive as to quantum, whilst leaving liability to be proved. The reasoning of the High Court of Australia becomes even more difficult to sustain when the underlying obligation of the principal is not the payment of money but the performance of some other contractual obligation. Quite apart from all the other undesirable ramifications of treating a conclusive evidence clause as transforming what would otherwise appear to be a guarantee into a performance bond that are referred to by O’Donovan and Phillips, unless the guarantee contains a monetary limit, (as true performance bonds almost invariably do) the surety

⁴⁹ As in, where the relevant wording was not confined to the conclusive evidence clause.

⁵⁰ As in *Close Investment Finance Ltd v Korpil* (unreported, 22 September 2009) discussed above in fn.45, and *West of England Shipowners Mutual Insurance Association (Luxembourg) v Cristal Ltd (The Glacier Bay)* [1996] 1 Lloyd’s Rep. 370, discussed in para.7–032.

⁵¹ It will be seen from the Australian cases referred to in O’Donovan and Phillips, *The Modern Contract of Guarantee* (2nd edn, 2010) in the footnotes to paras 5–148–5–151 that the courts there have resorted to construing conclusive evidence clauses strictly and contra proferentem in order to avoid this unpalatable result. In Queensland, the effect of the decision in *Dobbs* was expressly reversed by statute: s.57 of the Property Act 1974 provides that any such provision shall be construed as meaning that the certificate shall be received as prima facie evidence of any fact contained in it.

payments due from the promisor's own agent (for whose default he would be vicariously liable)¹⁴; a promise to pay money owed by the promisor to the promisee in satisfaction of the promisee's indebtedness to a third party¹⁵; a promise to be answerable for a debt only to the extent of the promisor's own indebtedness to the creditor¹⁶; and a promise by a judgment debtor to allow the judgment creditor to hold the judgment as security for the indebtedness to the creditor of a third party.¹⁷

The statute is therefore the origin of the distinction between contracts of guarantee and contracts of indemnity, the latter falling outside s.4, the former often, but not necessarily, falling within it.

Contract distinctions

3-006 The distinction between a contract of guarantee and a contract of indemnity has often led to a fine line being drawn by the court.¹⁸ A comparison of two cases illustrates the difficulty which may be caused by the subtlety of the distinction. In *Guild & Co v Conrad* [1894] 2 Q.B. 885, S orally promised C that if C would accept certain bills of exchange from a firm in which S's son was a partner, he, S, would provide C with funds to meet the bills. It was held that the contract was an indemnity and enforceable, because the contract was not a contract to pay if the son's business did not pay, but a contract to pay in any event.

On the other hand, in *Harburg India Rubber Comb Co v Martin* [1902] 1 K.B. 778, S was a director of a company who made an oral promise at a meeting of its creditors that he would indorse bills to the creditors for the amount of the company's debt. The court held that this was a promise to pay a debt for which the company remained primarily liable, and therefore unenforceable.

A simple test to see whether the surety's liability is original or contingent is to ask whether he would be liable irrespective of whether the principal is liable or has made default. If the answer to that question is yes, then the liability is original and the contract falls outside the Statute of Frauds.

It is a question of fact in each case whether the arrangement is one under which the surety's liability is original or collateral, and this means that the court will consider each case on its particular circumstances, and the language which was used by the parties at the time, though indicative of the nature of the bargain, will not necessarily be conclusive: *Simpson v Penton* (1834) 2 Cr. & M. 430. In *Van Der Merwe v IIG Capital LLC* [2008] 2 Lloyd's Rep. 187, Waller L.J. stated at [20] that "even minor variations in language plus a different context can produce different results". For this reason, the numerous decisions in past cases are of limited usefulness in determining on which side of the line a particular agreement

¹⁴ *Masters v Marriot* (1693) 3 Lev. 363.

¹⁵ *Andrews v Smith* (1835) 2 Cr. M. & R. 627; *Hodgson v James Anderson* (1825) 5 Dow. & Ry. K.B. 735.

¹⁶ *Arden v Rowney* (1805) 5 Esp. 254.

¹⁷ *Macrory v Scott* (1850) 5 Ex. 907.

¹⁸ In *Yeoman Credit v Latter* [1961] 1 W.L.R. 828 at 835, after analysing the foundation for the distinction, Holroyd Pearce L.J. said that it "has raised many hair-splitting distinctions of exactly that kind which brings the law into hatred, ridicule and contempt by the public".

will fall.¹⁹ However, certain features which emerge from the cases may assist. For example, one useful exercise is to ascertain whether the goods have been debited to the principal or to the surety in the creditor's books of account. If they have been debited to the principal, that is strong prima facie evidence that the surety's obligation was collateral rather than original.²⁰ On the other hand, if the surety has a direct interest in the underlying transaction this will often be an indication that his liability is intended to be original.

The principles stated above may be illustrated by considering the situation in which one person, S, agrees with a supplier of goods, C, to pay for goods which C supplies to another person, D. If the arrangement is that S will pay in any event, then the contract falls outside the statute: see *Edge v Frost* (1824) 4 D. & R. 243; *Lakeman v Mountstephen* (1874) L.R. 7 H.L. 17; and *Simpson v Penton* (1834) 2 Cr. & M. 430. If both D and S undertake liability for payment, so that they are jointly liable for the debt, again the case falls outside the statute, because S is under a direct and not a contingent liability to C: see *Scholes v Hampson and Merriot* (1806) in Fell's *A Treatise on the Law of Mercantile Guarantees* (2nd edn, 1825) at 27, 28. On the other hand, if S agrees that he will only make payment if D does not, the matter is within the scope of s.4: *Anderson v Hayman* (1789) 1 Hy. Bl. 120.

In determining whether the surety's liability is original or contingent, the court will be concerned with the substance of the transaction and not just with its form: see *Harburg India Rubber Comb Co v Martin* at 784-785. In *Actionstrength Ltd (t/a Vital Resources) v International Glass Engineering IN.GL.EN SpA* [2002] 1 W.L.R. 566 the Court of Appeal²¹ had to consider whether a promise made to a creditor to pay an amount owed to him by a debtor out of funds which the promisor himself owed to the debtor, fell within the Statute of Frauds. The alleged agreement was a promise by an employer to redirect moneys due to a contractor and use them to pay a sub-contractor to whom the contractor owed money. Although the original contractor plainly remained liable to the sub-contractor, the alleged surety raised the interesting argument that there is no guarantee within the Statute of Frauds when the promisor does not undertake to be liable generally, but only in respect of specific funds or sources within his control. Reliance was placed upon *Andrews v Smith* (1835) 2 Cr. M. & R. 627, *Steggall & Co v Lymburner* (1912) 14 W.A.L.R. 201, and a passage at p.68 of the Australian edition of O'Donovan and Phillips, *The Modern Contract of Guarantee* (3rd Australian edn, 1996).²²

In *Andrews v Smith* the defendant was a surveyor who was retained by the owner of a building to receive and pay over to a contractor named Hill such moneys as were due to him. The plaintiff agreed with the defendant that he would supply materials to Hill on the defendant's promise to pay for them out of the

¹⁹ For examples of promises which have been held to be original and not collateral, see the list in *Halsbury's Laws* (5th edn, 2008), Vol. 49, para.1059.

²⁰ *Austen v Baker* (1698) 12 Mod. Rep. 250; *Storr v Scott* (1833) 6 C. & P. 241.

²¹ The case went to the House of Lords on a different point: see the commentary in paras 3-002 and 3-031.

²² See now the commentary in the 2nd English edition of O'Donovan and Phillips *The Modern Contract of Guarantee*, (London: Sweet & Maxwell, 2010) at paras 3-017-3-021.

There was no specific mention in that paragraph of the express contractual entitlement to repayment of the instalments in the event of the builder's insolvency. The bank's obligations under the bond were set out in para.3. This provided that "in consideration of your agreement to make the pre-delivery instalments under the Contract . . . we hereby as primary obligor, irrevocably and unconditionally agree to pay you . . . on your first written demand, all such sums due to you under the Contract". The issue was whether on its true construction the bond obliged the bank to pay the amount of instalments recoverable by the purchaser under the contract in the event of the shipbuilder becoming insolvent. Simon J. [2009] EWHC 2624 (Comm) had no difficulty in deciding that it did, but the majority of the Court of Appeal reversed that decision. The critical (and only) issue was to identify what was meant by "such sums" in para.3. Patten L.J., with whom Thorpe L.J. agreed, opted for the natural construction, i.e. that it referred to the instalments of the price that were repayable in the circumstances specified in cl.2. This was justified by Patten L.J. on the basis that the alternative of construing "such sums" as referring to all pre-delivery instalments becoming repayable in any circumstances robbed para.2 of any purpose or effect.

Sir Simon Tuckey (the only member of the Court of Appeal in that case to have sat in the Commercial Court) referred in his dissenting judgment to the classic statements by Lord Reid in *Wickman Machine Tools Sales Ltd v Schuler AG* [1974] A.C. 235 at 251 and Lord Diplock in *Antaios Compania Naviera v Salen Rederierna AB (The Antaios)* [1985] A.C. 191 at 201 to the effect that if there are two possible constructions, the court is entitled to reject the one which is unreasonable, and in a commercial context, the one which flouts business commonsense. He decided that the bond was ambiguous¹⁵ and that although at first sight, the bank's argument appeared compelling, the words "all such sums due to you" were quite capable of being construed as referring back to "the pre-delivery instalments" in the first sentence of para.3. Whilst accepting the principle that a judge should proceed with caution before concluding that a suggested contract term is surprising or uncommercial, he pointed out at [30] that no credible commercial reason had been advanced as to why the parties, or the buyers' financiers, should have agreed to cover every situation in which the instalments would be refunded *except* that of the shipbuilder's insolvency. On the contrary, the exclusion made no commercial sense; as the judge had said, insolvency of the builder was the situation for which the security of an advance payment bond was most likely to be needed. Patten L.J.'s answer to that was that there is a difference between a situation in which one construction would lead to an "arbitrary and irrational" result, and a situation in which the contractual provisions are relatively clear in their meaning but balance the interests and obligations of the parties in a way which the judge considered to be one-sided or unfair. He took the view that this case fell into the latter category. The construction put forward by the bank was the meaning which the document would convey to a reasonable person reading it with knowledge of the shipbuilding contract, and the obvious purpose of para.2 was to give the addressee a clear statement of the builder's obligations under the contract that were to be covered by the

¹⁵ As was conceded by counsel for the bank, and accepted also by the majority.

guarantee (in line with the terms of the underlying shipbuilding contract). Therefore, the court would be falling into the error of re-writing the contract if they were to accede to the purchasers' submissions. He concluded that:

"[M]erely to say that no credible commercial reason has been advanced for the limited scope of the bond does, in my view, put us in real danger of substituting our own judgment of the commerciality of the transaction for that of those who were actually party to it."

On Patten L.J.'s approach, business common sense would only be flouted if the construction in question would make the agreement unworkable, as for example it would have done in *Ostfriesische Volksbank EG v Fortis Bank NV* (discussed above). It is respectfully submitted that this is too narrow an interpretation of the principle enunciated by Lord Reid and Lord Diplock. It is difficult to see how the majority could have reached the conclusion that the construction they favoured did not flout business common sense in the ordinary meaning of that phrase, because it produced a result which rendered the bond largely useless for the purpose it was designed to serve. As to the point made by Patten L.J. that para.2 could have been omitted in its entirety if the purchasers' construction was correct, there are many examples of cases where an argument that a particular clause would be rendered otiose by a particular construction has been held to be no bar to adopting that construction if it plainly reflected the objectively manifest intention of the contracting parties. Paragraph 2 could have been regarded as being in the nature of a preamble describing in general terms the right of the buyer to recover money back from the builder, rather than an exhaustive list of the circumstances in which the buyer might wish to call on the bond. If it had really been intended to circumscribe the situations in which use could be made of the bond to claim immediate repayment of those instalments, one might have expected the restrictions to appear explicitly in para.3 itself, as Tuckey L.J. pointed out. The real problem was that in order to achieve a result that made commercial sense in that context, it would have been necessary to ignore what at first sight appeared to be the natural and obvious construction of the bond. The latter prevailed because the contract was still workable, even though it may not have given the purchaser the full protection it desired. The case therefore provides a salutary lesson to those who wish to be protected against the insolvency of the contractor to make sure that that eventuality is expressly covered in the bond, or, where (as it often is) the language of the bond is dictated by the terms of the underlying shipbuilding contract, in the language of that contract. No doubt purchasers under shipbuilding contracts will be astute to ensure that they do not fall foul of such provisions in the future.

A surety will not be relieved from liability because the language that has been used exposes him to a wider liability than he subjectively intended, even if the court may be of the opinion that had he appreciated the full consequences resulting from the guarantee, he would not have entered into it.¹⁶ However, he may be

¹⁶ *Stewart and McDonald v Young* (1894) 38 S. J. 385; *Bank of BNA v Cuvillier* (1861) 14 Moo. P.C. 187, per Lord Cranworth; *London Assurance Co v Bold* (1844) 6 Q.B. 514.

outstanding balance. A and the finance companies between them paid W part of the price of the goods, but A failed to pay the balance and went into liquidation. W made a formal demand under the guarantee and then sued the guarantor. The guarantor argued that its guarantee only applied to the obligations of A under the original sale and purchase contract and that the arrangements with the finance companies resulted in fresh contracts which fell outside the terms of the guarantee. Although it had agreed to the new arrangements, they were novations, not variations, and the fact that a guarantor knows of and consents to such a course is not enough to bring the new obligations within the scope of his guarantee.

The Court of Appeal decided that the guarantee did cover W's claim for the balance, though the members of the court differed in their reasoning. Since the background against which the guarantee was entered into was the clear contemplation and acceptance of the fact that outside financing was bound to be procured by A, it would be commercially astonishing if the guarantee was meaningless. The majority view was that if the new arrangements had involved a discharge of the original contract and its replacement by three new contracts, the judge was wrong in construing the guarantee as extending to those new contracts on the basis that the original sale contract envisaged that such agreements would be entered into. However, Moore-Bick L.J. (with whom Ward L.J. agreed) decided that the effect of the financing arrangements was not to discharge the original contract of sale, but merely to reduce the amount of A's obligation under that contract to pay W for the goods, so that the guarantee would be construed as continuing to operate on the balance remaining after receipt of the money from the finance companies. Buxton L.J. upheld the judge's view that the guarantee should be construed as extending to the new contracts. Although the original contract did not oblige W to enter into any arrangement with a finance company, W was no ordinary guarantor and A was no ordinary contracting party. The provision of the lease contracts were essential to the sale going forward in the first place, and had been contemplated from the outset: thus it would be absurd to construe the guarantee as limited to liability arising out of direct contracts of sale between W and A, contracts which on the judge's findings everyone concerned knew were never going to take place. Ward L.J., however, opined that this pushed the limits of creative construction too far when it was unnecessary to do so.

Variations outside the purview of the original contract

- 4-026 A more fundamental problem, which has recently been highlighted by the Court of Appeal, lies in ascertaining or seeking to define the limits on the extent to which the guarantor's consent to future variations of the principal contract can make him responsible for the performance of that contract when varied. As already discussed, the principle of co-extensiveness would normally dictate that by consenting to the variation of the principal's obligations the surety has agreed to make himself liable for those obligations as varied, even though the variation would increase the burden and/or the risk which he initially undertook. On the other hand, the discharge of the underlying agreement and its replacement by another agreement would ordinarily bring the surety's obligations to an end. However, there may be cases falling short of a novation, in which the original

agreement has been altered so often or so much that it no longer resembles the bargain which the surety initially consented to guarantee. Does it necessarily follow that by agreeing to a guarantee containing a term allowing variations or amendments to the underlying agreement without further reference to him, the guarantor has irrevocably bound himself to act as surety in a transaction which may, in future, change beyond all recognition from the original deal for which he consented to take on a secondary liability? This was the issue which the Court of Appeal considered in the important case of *Triodos Bank NV v Dobbs* [2005] EWCA Civ 630, [2005] 2 Lloyd's Rep. 588, a judgment which pre-dates *Moat Financial Services v Wilkinson* by six months.

In 1996, Mr Dobbs executed a personal guarantee whereby he agreed to pay all monies due and owing to the bank "under or pursuant to" two separate loan agreements made on the same date with a company of which he was a director. The guarantee was limited to £50,000 and the total amount advanced under the two loan agreements was at that stage £900,000. Part of this money, advanced under the first agreement, was used to repay a previous lender, and the balance, advanced under the second agreement, was used to finance phase 1 of a construction project in which the company was engaged. The guarantee provided that the guarantor:

"[G]uarantees that it will on demand pay to the Bank and discharge all monies and liabilities whether or principal, interest or otherwise, which now are or may at any time hereafter . . . be due, owing or incurred by the Company to the Bank under the Loan Agreement."

It also contained the usual standard form provision enabling the bank, at any time as it thinks fit and without reference to the Guarantor, to "grant time for payment or grant any other indulgence or agree to any amendment, variation, waiver or release in respect of an obligation of the Company under the Loan Agreement". By the end of 1998, phase 1 of the project had been completed, and the amount of the company's indebtedness had been reduced by £100,000. The bank agreed to finance phase 2 of the project, and agreed to lend a total of £1,980,000 to the Company (this figure included the £800,000 which remained outstanding under the 1996 loan agreements) under two new loan agreements which stated that they "replaced" the earlier agreements. The security for the new loan agreements was expressly stated in those agreements to include the "existing guarantee of [Mr Dobbs] in the sum of £50,000". In 1999, the two 1998 loan agreements were replaced in turn by a further single loan agreement under which the facility afforded to the company was increased to a maximum of £2.6 million. The facility specified that the bank should continue to have the benefit of the personal guarantee given by Mr Dobbs in 1996. Unlike the creditor in *Moat Financial Services v Wilkinson*, the bank does not appear to have gone to the trouble of asking Mr Dobbs to countersign the "replacement" agreements, let alone a side letter confirming that the existing guarantee was to be treated as covering the indebtedness under them, but he plainly knew about the terms of the facilities. In 2000, the bank called in the loan and subsequently appointed administrative receivers over the company. In due course, the site was sold and there was a shortfall in the indebtedness of just over £80,000. The bank then made a demand on Mr Dobbs under his guarantee for £50,000.

the position of the debtor from what the surety might naturally expect but (2) the creditor is not obliged to disclose to the surety other matters relating to the debtor which might be material for the surety to know.

In support of his conclusion that the duty of disclosure was of a wider ambit, the trial judge, Newey J., had relied upon the judgment of Vaughan Williams L.J. in *London General Omnibus Co Ltd v Holloway* [1912] 2 K.B. 72 in which, after referring to *Lee v Jones* (1864) 17 CB (NS) 481 and *Hamilton v Watson*, he said:

“Lord Campbell, it is true, takes as his example of what might not be naturally expected an unusual contract between creditor and debtor whose debt the surety guarantees, but I take it this is only an example of the general proposition that a creditor must reveal to a surety every fact which under the circumstances the surety would expect not to exist, for the omission to mention that such a fact does exist is an implied representation that it does not. Such a concealment is frequently described as ‘undue concealment’.”

The Chancellor pointed out that neither Farwell L.J. nor Kennedy L.J. specifically concurred in that statement and that at 87, Kennedy L.J. approved a statement in *Pollock's Principles of Contract* (8th edn, 1911) p.568 that “the creditor is not bound to volunteer information as to the general credit of the debtor or anything else which is not part of the transaction itself to which the suretyship relates; and on this point there is no difference between law and equity”. In the Chancellor's view, in the passage relied upon, Vaughan Williams L.J. appeared to be seeking merely to apply the principle recognised by Lord Campbell. Indeed if the words “between the parties who are concerned in the transaction” had been inserted between “every fact” and “which under the circumstances”, he would have been. If the passage meant what counsel for the guarantors in *North Shore Ventures* submitted it did, it was contradicted by the passage in the judgment of Kennedy L.J. quoted above. The formulation of the principle by the Court of Appeal in *Lloyds Bank Ltd v Harrison* (1925) *Legal Decisions Affecting Bankers* Vol.4 p.12 and by Lord Nicholls and Lord Scott in *Royal Bank of Scotland v Etridge (No 2)* at [81] and [188] respectively was that of Lord Campbell in *Hamilton v Watson* and not that of Vaughan Williams L.J. Further, the conclusion of the House of Lords in *Bank of Scotland v Bennett*, one of the conjoined appeals with *Etridge*, applied the principle enunciated by Lord Campbell.

It would appear from [14] of the Chancellor's judgment that the principle would cover an informal arrangement between the principal and the surety, such as the practice adopted by the bank in *Commercial Bank of Australia v Amadio* (1983) 151 C.L.R. 447 of selectively dishonouring cheques drawn on the borrower's account so as to create the impression that its business was more successful than it was, the secret arrangement between the bank and its customer in *Pendelbury v Walker* (1841) 4 Y. & C. Ex. 424, and the conspiracy to defraud the Russian exchange control authorities in *Far Eastern Shipping Plc v Scales Trading Ltd* [2001] 1 All E.R. (Comm) 319 discussed below. All those arrangements had as much potential to injure the surety as a formal contractual obligation.

The jurisprudential basis for the duty of disclosure is somewhat unclear. In some cases the duty has been said to arise from the presumed basis of the

guarantee: see e.g. *Westpac Securities v Dickie* [1991] 1 N.Z.L.R. 657 at 662–663. However the rationale which appears to be most favoured is that the failure to make disclosure amounts to an implied representation that the undisclosed facts do not exist. Indeed the origins of the principle can be traced back to dicta in certain nineteenth-century cases to the effect that asking the surety to enter into the contract involves a representation that there is no unusual feature about the transaction affecting the risks which he is being asked to undertake: see, e.g. *Lee v Jones* (1864) 17 C.B.N.S. 482 at 503.⁵⁹ In *Bank of India v Patel* [1982] 1 Lloyd's Rep. 506 at 515 col.1, Bingham J. said that the surety would be discharged, *inter alia*, “if the creditor is guilty of concealment amounting to misrepresentation”. This passage was approved by Robert Goff L.J. when the case went to the Court of Appeal: [1983] 2 Lloyd's Rep. 298 at 301–302.⁶⁰ The same rationale appears to underlie the decision of the Court of Appeal in *North Shore Ventures Ltd v Anstead Holdings Inc* (above). Despite this rationale, the principle does not appear to be confined to circumstances where the non-disclosure can be characterised, without undue artificiality, as tacit misrepresentation. If this were so, then contracts of suretyship would be no different from any other ordinary contract. In *Credit Lyonnais v ECGD* [1996] 1 Lloyd's Rep. 200 Longmore J. expressed the view that the concept of “implied representation” could not apply to banking cases so easily as perhaps it could to a guarantee of an employee's fidelity.

Unusual features

The recent restatements of the principle by the Court of Appeal emphasise that, so far as the underlying contractual relationship between principal and creditor is concerned, the duty relates only to “unusual features”, which is no doubt intended to reflect the general rule that the surety is expected to find out for himself anything material to the risk which might be expected to arise in the ordinary course of events. If the matter is something which the creditor would normally expect the surety to find out for himself, the defence will not run—see e.g. *Bank of Scotland v Henry Butcher & Co* [2001] 2 All E.R. (Comm) 691.⁶¹ Of course there is no duty to disclose something that is already known to the prospective surety. Tipping J. said in the New Zealand case of *Shivas v Bank of New Zealand* [1990] 2 N.Z.L.R. 327 at 364 that “the bank's duty of disclosure must be assessed against what the bank might reasonably have expected the intending guarantors to know already or to be able to ascertain without difficulty should they have been minded to do so”. In *North Shore Ventures*, the Chancellor said that that statement must be read as an application of the general principle, and not an exception from it. Counsel for the creditor had submitted, in reliance on that statement, that the duty of disclosure did not extend to matters which the creditor reasonably believed that the guarantor already knew. The

5-016

⁵⁹ See also *London General Omnibus Co Ltd v Holloway* [1912] 2 K.B. 72 at 78; *Geest v Fyffes* [1999] 1 All E.R. (Comm) 672 at 682–683.

⁶⁰ The same rationale was applied in New Zealand in *National Mortgage & Agency Co of New Zealand Ltd v Stalker* [1933] N.Z.L.R. 1182, in which it was said that it depended on the nature of the transaction in each case whether the material fact not disclosed was impliedly represented not to exist.

⁶¹ Discussed at para.5–017. See also *Wason v Wareing* (1852) 15 Beav. 151; *Bank of Australasia v Reynell* (1891) 10 N.Z.L.R. 257; *Behan v Obelan Pty Ltd* (1985) 157 C.L.R. 326.

from their deposit accounts and apply it to satisfaction of the company's debts. At 447, Dillon L.J. said of the principal debtor clause:

"[T]he effect of this must be to dispense with any need for a demand in the case of [surety 1] since he has made the companies' debts to BCCI his own debts and thus immediately payable out of the deposit without demand. In the case of [surety 2] there must be immediate liability even though the word "demand" was used, *because he accepted liability as a principal debtor* and his deposit can be appropriated without further notice."¹⁹ [Emphasis added]

This aspect of the decision in *MS Fashions* was followed by David Richards J. in *TS&S Global Ltd v Fithian-Franks* [2007] EWHC 1401 (Ch), [2008] 1 B.C.L.C. 277. The creditor had served statutory demands on five shareholders who had given personal guarantees for the obligations of their company under a supply agreement with the creditor. However, no prior demand had been made under the guarantees. The guarantee provided in cl.1 that:

"[T]he guarantors, as primary obligors, hereby irrevocably and unconditionally guarantee to the Beneficiary the due payment and discharge by the Company of such amount as is due and owing by the Company to the Beneficiary as at the first anniversary of the date hereof."

It also provided in cl.2 that if the Company defaulted in payment of the sums due as and when they fell due, the guarantor would pay the Beneficiary on demand, without set off or counterclaim, an amount equal to the amount so unpaid together with certain costs and expenses. The guarantors argued that the statutory demands should be set aside because there was no liability unless and until the creditor had demanded payment from them under the guarantees. They sought to distinguish *MS Fashions* on the basis that the issue in that case was whether a liability had arisen for the purposes of set-off under the version of r.4.90 of the Insolvency Rules which was then in force, not whether a demand was necessary before the liability became immediately payable.²⁰ The judge refused to distinguish the case on that basis, observing that Dillon L.J.'s judgment proceeded on the basis that because the sureties had covenanted to pay as principal debtors, their position was equated with that of a primary debtor, who is under an immediate obligation to pay whether or not the contract provides for a demand to be made. Dillon L.J. was not saying that the equation only existed for the purposes of set-off only. The judge also rejected the secondary submission that, even if cl.1 of the guarantee created an accrued rather than a contingent liability to pay, cl.2 made a demand a

¹⁹ Surety 2 had signed a guarantee containing a covenant stated to be a "separate and independent obligation" that "on demand in writing the companies' liabilities would be recoverable from him as principal debtor"—see the judgment of Hoffmann J. [1993] Ch. 427 at 430. Although the House of Lords cast doubt on the correctness of the decision in *MS Fashions* in *Re BCCI (No.8)* [1998] A.C. 214, they did so on grounds which did not impugn the validity of the decision on this particular point.

²⁰ A new rule 4.90 was substituted in 2005, and the problem identified in *MS Fashions* and by Lord Hoffmann in *Re BCCI (No.8)* [1998] A.C. 214 no longer exists: see Ch.11 at 11–013.

condition precedent to the obligation to pay so that a statutory demand could not be served unless and until a demand had been made. The problem with that proposition was that it was directly contrary to the line of authorities culminating in *Bradford Old Bank v Sutcliffe* [1918] 2 K.B. 833. However, at [27] of his judgment the judge expressed some sympathy with commercial parties to a guarantee who could reasonably read Cls 1 and 2 as having precisely the effect for which counsel for the shareholders was contending: he indicated that perhaps that result could have been achieved by the use of different language in the contract, but on the basis of the authorities the words "on demand" would not suffice.²¹

It follows from the effect that a "principal debtor" clause may have on a true contract of guarantee that if the contract of suretyship is properly classified as an indemnity, even an express statement in the contract that the indemnifier is liable to pay "on demand" is unlikely to be construed as requiring the creditor to make a demand on the surety before suing him, for exactly the same reason that the words do not require a demand to be made on the principal. However, it would always be a wise precaution for the creditor to serve a demand on the surety if express reference to a demand is made in the body of the contract of suretyship.

Compliance with a contractual requirement for a demand

If the guarantee does require a demand to be made, and the requirement for a demand is not waived by the guarantor, the question whether a particular demand meets the contractual requirements is a matter of construction in each case. A statutory demand will not suffice, because s.268 of the Insolvency Act, the Insolvency Rules and the prescribed form of demand are all premised on the basis that the debt is immediately payable by the time that the statutory demand is served: *TS&S Global Ltd v Fithian-Franks* [2007] EWHC 1401 (Ch), [2008] 1 B.C.L.C. 277, at [30]–[32]. Accordingly, unless the surety has undertaken a primary liability, the creditor must serve any requisite contractual demand before he serves a statutory demand on him. It should be noted, however, that in the *TS&S Global* case, David Richards J. indicated that the court would not necessarily set aside a statutory demand which, in error, had not been preceded by service of a contractual demand. The court has a discretion and if the sureties would not have paid or secured the debt if they had been served first with a contractual demand, they may find it difficult to show that they have suffered any prejudice in consequence of the creditor's failure to go about things in the right way. It would be different, of course, if there were serious substantive grounds for disputing liability under the guarantee.

In the Australian case of *Re Colonial Finance, Mortgage Investment and Guarantee Corporation Ltd* (1906) 6 S.R.N.S.W. 6 at 9, Walker J. gave this definition of a valid demand:

²¹ Cf. the decision of the Singapore Court of Appeal in *PT Jaya Sumpiles Indonesia v Kristle Trading Ltd* [2009] 3 SLR 689 where despite the presence of a "primary obligor" provision it was held, on construction of the guarantee as a whole, that time did not start to run for the purposes of limitation until demand was made on the sureties.

irrevocable transaction in reliance upon the guarantee, he should not be deprived of his security by the voluntary act of the surety. Otherwise the creditor might be induced to make a substantial loan to the principal on the faith of a guarantee by the surety, only to find that the surety determines the guarantee voluntarily immediately after the advance has been made, leaving the loan unsecured.

When is the underlying consideration divisible?

8-004 It is often difficult to determine whether the consideration for a guarantee is entire or divisible. In the case of a guarantee for rent, if the tenancy is for a fixed period of a number of months or years, then prima facie the consideration is indivisible and the guarantee may not be revoked. On the other hand, a guarantor of rent payable from week to week may give notice of revocation. In *Wingfield v De St Croix* (1919) 35 T.L.R. 432, the principal was a gardener working for the surety, who entered into occupation of a cottage belonging to the creditor. The surety guaranteed the rent for three months and from week to week thereafter. Four months after the tenancy began, the gardener left the service of the surety, and the surety gave the creditor a week's notice of termination of the guarantee. It was held that the guarantee was continuous and that the consideration was divisible, and consequently it could be terminated by notice.

The problem most frequently arises in the context of fidelity guarantees. It has been held that a fidelity bond given to secure the due performance of an office by the principal cannot be revoked, on the ground that the appointment of the principal is an indivisible consideration.⁸ However, one matter which does not appear to have been considered by the courts, and which is of particular relevance to fidelity guarantees, is whether the surety may revoke the guarantee if the creditor has a right to terminate the underlying principal contract by giving a specified period of notice. In such a case, it is strongly arguable that the consideration is divisible: the creditor is not prejudiced by the surety having a right to revoke the guarantee, because on receipt of notice of revocation from the surety he may decide whether or not to terminate the underlying transaction.⁹

Specific guarantees

8-005 In the absence of an express term allowing the surety to give notice of termination, the general rule is that a specific guarantee is not determinable. This is because a creditor who has entered into an irrevocable transaction on the strength of a guarantee should not be deprived of his security by its subsequent revocation or cancellation.¹⁰ Attempts by sureties to establish that there was a collateral oral agreement entitling them to revoke the guarantee on the happening of a certain future event (such as resignation from the post of director of the company which is the principal debtor, or repayment of a specific amount of the principal

⁸ *Re Crace* [1902] 1 Ch. 733, *Gordon v Calvert* (1828) 4 Russ. 581. See also *Burgess v Eve* (1872) L.R. 13 Eq. 450. Similar results have been reached in other jurisdictions, see, e.g. *R v Leeming Applegarth's Executors* (1850) 7 U.C.R. 306 (Can); *Myingan Municipality v Maung Po Nyun* (1930) I.L.R. 8 Ran. 320 (Ind); cf. *North British Mercantile Insurance Co v Kean* (1888) 16 O.R. 117 (Can).

⁹ This view is shared by the editors of *Chitty on Contracts* (30th edn, 2008) Vol. 2, para.44-017.

¹⁰ See *Lloyd's v Harper* (1880) L.R. 16 Ch. D. 290, and the discussion above.

indebtedness) have generally been unsuccessful: see e.g. the recent decision of Eder J. in *National Westminster Bank v Binney* [2011] EWHC 694 (Q.B.).¹¹

The effect of revocation

If the surety is entitled to revoke or cancel a guarantee on giving notice to the creditor, the revocation will not affect rights which have accrued prior to the date of termination.¹² Thus, in the case of a guarantee of an overdraft, the guarantor's liability does not remain static at the date of termination. He will remain liable for the principal amount outstanding at that date, together with any interest which has already accrued on it or which may accrue thereafter, and he is only exonerated in respect of any future advances of further principal sums. He may terminate his liability altogether by paying the creditor the sum outstanding at the date of termination, up to the limit of his guarantee.¹³ It has been suggested in Canada that withdrawal from or cancellation of the guarantee is only effective if the notice is accompanied by payment of the full amount then due and owing.¹⁴ However, this does not accord with the underlying rationale, or with the majority of the authorities on the subject, which place no such limitation on the right of revocation: the surety's right to revoke a standing offer is not conditional upon his satisfaction of earlier bargains. Further, the amounts advanced by the creditor may not be repayable at the time when the guarantee is cancelled, and if the surety volunteers payment prematurely, he may not be entitled to recover the money from the principal. See further the critique in McGuinness, *The Law of Guarantee*, (2nd edn, 1996) at para.6.61, fn 214.

The surety is only entitled to call upon the principal to release or indemnify him when his liability to the creditor has accrued; this may occur as soon as he has given notice of cancellation. When the notice expires and possibly before, he may seek *quia timet* relief against the principal.¹⁵

Once a guarantee has been revoked, the liabilities of the surety cannot be revived unless there is a fresh agreement which complies with all the necessary formalities. In *Silverburn Finance (UK) Ltd v Salt* [2001] 2 All E.R. (Comm) 438, the claimant, S, was a finance company which factored invoices on a recourse basis for a company, N, under an agreement dated September 19, 1991. In 1992, the defendants, who were the directors of N, executed written guarantees to pay

¹¹ See also *Australian Postal Corp v Oliver* [2006] VSC 118, in which the express provisions of the guarantee providing for termination of future liability on one month's notice conflicted with any immediate right of revocation by the guarantor when he ceased to be a director.

¹² *Tooke Bros Ltd v Al-Walters Ltd* [1935] D.L.R. 295; *Westminster Bank Ltd v Sassoon* (1926) 5 Legal Decisions Affecting Bankers 19 CA; *Commercial Bank of Australia Ltd v Cavanaugh* (1980) 7 N.T.R. 12; *AG Canada v Bank of Montreal* (1984) 32 Man. R. (2d) 98; *National Westminster Bank Ltd v French* (unreported) October 20, 1977; *National House Building Council v Fraser* [1983] 1 All E.R. 1090; see also *JR Watkins Co v Robertson* [1928] 1 D.L.R. 979. Cancellation is not the same as discharge: cancellation exonerates the surety from future liability, whereas discharge frees him from existing liabilities, see *Royal Bank v TVM Catering Ltd* (1980) 23 B.C.L.R. 199.

¹³ See *Beckett & Co v Addyman* (1881-22) L.R. 9 Q.B.D. 783 at 791; *Burgess v Eve* (1872) L.R. 13 Eq. 450.

¹⁴ By Wilson J. in *Benge v Hanna* (1979) 100 D.L.R. (3d) 218 at 226, citing in support *Royal Bank v Sterns* [1924] 3 D.L.R. 1050; *Starrs v Cosgrave Brewing & Malting Co* (1886) 12 S.C.R. 571 at 593-594 and *Burgess v Eve* (1872) L.R. 13 Eq. 450.

¹⁵ *Morrison v Barking Chemicals Co Ltd* [1919] 2 Ch. 325, and see Ch.10, paras 10-025 and following.

accepting of a new bill instead of payment,¹⁸⁷ or renewing a promissory note will discharge the surety,¹⁸⁸ as will the acceptance of a further security for the guaranteed debt with a covenant for payment at a later date.¹⁸⁹

The surety will not be discharged by taking security for a debt at a future point in time while retaining the right to sue on the original debt¹⁹⁰; equally, where the principal gives the creditor an assignment of chattels by way of security which is not enforceable until a notice period has expired but the principal's personal liability is not postponed, the surety remains liable.¹⁹¹ Similarly, where the creditor takes as security both a mortgage not enforceable until a date certain and, as a collateral security, a promissory note guaranteed by the surety, the surety is not discharged by the fact that the mortgage was executed subsequently to the promissory note.¹⁹² However, where the receipt of interest by the creditor amounts to an agreement by him not to sue for the principal amount until the date for payment of interest has arrived, the surety will be discharged, this being an agreement to give time.¹⁹³

Scope of the rule

9-032 The rule will apply to discharge sureties who originally contracted as co-principals, but before time was given, became sureties, provided the surety (once a co-principal) agrees with the principal and the creditor has notice of the fact.¹⁹⁴ However, where a person contracting originally as surety becomes a principal, he is not released by reason of time being given to the original principal.¹⁹⁵ Nor does the rule serve to discharge a person who does not in fact occupy the position of surety,¹⁹⁶ such as a company director who is deemed by statutory provision to be liable for the company's debt.¹⁹⁷

Where the surety is liable for several separate and distinct obligations, time given in respect of one such obligation will not discharge the surety as to the remainder. This is so whether the obligations arise under one contract or under separate contracts.¹⁹⁸ For example, in *Croydon Commercial Gas Co v Dickinson*

¹⁸⁷ *Overend Gurney & Co (Liquidators) v Oriental Financial Corp Ltd* (1874) L.R. 7 H.L. 348; *Wyke v Rogers* (1852) 21 L.J. Ch. 611, where the acceptance of a post-dated promissory note by the creditor discharged the surety.

¹⁸⁸ *Goldfarb v Bartlett* [1920] 1 K.B. 639.

¹⁸⁹ *Provincial Bank of Ireland v Fisher* (1919) 2 I.R.R. 249.

¹⁹⁰ *Munster & Leinster Bank v France* (1889) 24 L.R. I.R. 82.

¹⁹¹ *Lindsay v Lord Downes* (1840) 2 Ir. Eq. R. 307, where the creditor had both a bond for the debt then outstanding and bills falling due at different dates.

¹⁹² *Twopenny v Young* (1824) 3 C. 208; the mere taking of further security is not, without more, the giving of time: see *Swire v Redman* (1876) 1 Q.B.D. 536.

¹⁹³ *Boaler v Mayor* (1865) 19 C.B. (N.S.) 76.

¹⁹⁴ *Blake v White* (1835) 1 Y. C. Eq. 420.

¹⁹⁵ *Rouse v Bradford Banking Co* [1894] 2 Ch. 32, where a partner, who retired from a firm and took a covenant that they would pay the partnership debts and indemnify him, became in effect surety to those creditors with notice of the dissolution. A provision in the covenant to the effect that so long as he was indemnified he was not entitled to insist that they pay the debts did not deprive him of the right to be discharged on the giving of time to the continuing partners.

¹⁹⁶ *Reade v Lowndes* (1857) 23 Beav. 361; *Greenwood v Francis* [1899] 1 Q.B. 312. In the latter case it was left open as to whether a surety could discharge his co-surety by agreeing to give time to the principal.

¹⁹⁷ *Way & Hearn* (1862) 11 C.B. (N.S.) 774, where the surety had in fact merely given an indemnity in respect of a particular loss; applied in *Walker Crips Stockbrokers v Savill* [2007] EWHC 2598 at [76].

¹⁹⁸ *British Airways v Parish* [1979] 2 Lloyd's Rep. 361.

(1876) L.R. 2 C.P.D. 46 the principal had contracted with the creditor to purchase gas by-products, the surety having guaranteed monthly payment of the price. It was held that time given by the creditor in relation to one monthly payment discharged the surety only in respect of that payment; the surety was not discharged from liability for the principal's obligations otherwise.¹⁹⁹ Similarly in *Bingham v Corbet* (1864) 34 L.J.B.Q. 37, the surety had given a continuing guarantee for a contract for the price of goods to be supplied, and time was given in respect of an amount due, the creditor reserving his rights in relation to future supplies. The surety remained liable in respect of future amounts.²⁰⁰

Reservation by the creditor

Where the creditor reserves his rights to proceed against the surety when giving time to the principal, the surety will not be discharged.²⁰¹ It has been seen that one of the justifications for the rule that the surety is released by the giving of time to the principal is that otherwise the creditor would derogate from his grant in leaving the principal still potentially liable to the surety.²⁰² The justification for the protection of the creditor who reserves his rights against the surety appears to be that the principal has notice that he will continue to be liable to the surety notwithstanding the creditor's agreement with the principal to give him time, and so there is no basis for discharging the surety.²⁰³ However, this rather assumes that the principal has sight of or is a party to the guarantee. Further, as will be seen,²⁰⁴ the effectiveness of provisions in the guarantee whereby the creditor reserves his rights against the surety is not wholly free from doubt.

The effect of a reservation of time is to transmute the promise of the creditor to extend time into a mere covenant not to sue, as opposed to a binding release.²⁰⁵ The essential difference between giving time and other variations of the principal agreement discharging the surety is that, so long as the creditor reserves his rights against the surety, the consent of the surety is not essential to protect the creditor's rights against him: the surety will remain bound.²⁰⁶ Further, it is not necessary that the reservation of rights be communicated to the surety.²⁰⁷ There is no reason, it is

¹⁹⁹ *Harrison v Seymour* (1866) L.R.1 C.P. 518.

²⁰⁰ See the analysis of this case in *Bank of Baroda v Patel* [1996] 1 Ll. Rep. 391. But compare with *Midland Motor Showrooms v Newman* (1929) 2 K.B. 256; *WR Simmons v Meek* [1939] 2 All E.R. 645.

²⁰¹ See *Halsbury's Laws* (5th edn, 2008) Vol. 49, para. 1231; *Tatum v Evans* (1885) 54 L.T. 336; *Boaler v Mayor* (1865) 19 C.B.N.S. 76, 144 E.R. 714; *Nichols v Norris* (1831) 3 B. & Ad. 41; *Bateson v Gosling* (1871) L.R. 7 C.P. 9; *Overend Gurney & Co (Liquidators) v Oriental Financial Corp Ltd* (1874) 7 H.L. 348; *Mahant Singh v U Ba Yi* [1939] A.C. 601; *Greene King Plc v Stanley* [2001] EWCA Civ 1966, [2002] B.P.I.R. 491 a case about release in the context of an IVA (see para.9-014), and see also *Prudential Assurance Co Ltd v PRG Powerhouse Ltd* [2008] 1 B.C.L.C. 289, Etherton J.

²⁰² See para.9-029.

²⁰³ *Webb v Hewitt* (1857) 3 K.J. 438.

²⁰⁴ See para.9-034.

²⁰⁵ *Re Armitage Ex p. Good* (1877) 5 Ch. D. 46.

²⁰⁶ *Keasley v Cole* (1846) 16 M. W. 128; *Bateson v Gosling* (1871) L.R. 7 C.P. 9.

²⁰⁷ *Webb v Hewitt* (1857) 3 K.J. 438; *Boaler v Mayor* (1865) 19 C.B.N.S. 76. Compare the position in the cases under the rule in *Holme v Brunskill* where the surety's consent to the variation is essential for the surety to remain bound.

equitable right to claim exoneration from the principal as soon as he is exposed to liability—see the discussion of *quia timet* relief in paras 10–025 and following.

Despite the fact that the debt between the surety and the principal usually arises on payment, any contract from which the right of indemnity emanates is almost certain to have been made at an earlier date, namely whenever the express or implied request to the surety was made or, at the latest, acted upon: *Re A Debtor* [1937] Ch. 156. This was important on the facts of that particular case. The surety had guaranteed the bank account of a married woman. Subsequently the Law Reform (Married Women and Tortfeasors) Act 1935 was enacted, which provided that no action might be brought against a married woman in respect of a contract or obligation entered into before the passing of the Act. The surety was called upon to pay under the guarantee after the Act was passed, but he could not recover the sum from the woman, because the implied agreement to indemnify him had been made before the Act.

In most cases, the time at which the contract or obligation to indemnify arose is unlikely to be of importance, since nowadays legislation which invalidates transactions retrospectively is rarely passed.

Effect of date of accrual

- 10–013 The general rule that no right of indemnity (or debt) accrues until payment by the surety has several consequences in the following contexts: periods of limitation, administration of estates, and bankruptcy and liquidation. The first two are dealt with in this chapter. The effect of the rule in the context of insolvency is dealt with in Ch.13.

Limitation period

- 10–014 In the absence of agreement to the contrary, the limitation period will not start to run against the surety in favour of the principal until he has paid the creditor: *Collinge v Heywood* (1839) 9 Ad. & El. 633; *Re Mitchell* [1913] 1 Ch. 201. If the surety has only paid part of the debt, the limitation period will run only in respect of that part: *Davies v Humphreys* (1840) 6 M. & W. 153.

Administration of estates

- 10–015 In *Re Mitchell*, [1913] 1 Ch. 201, the question which arose was whether the release of “all debts” to a principal debtor by a surety’s will affected the right of his executors to claim against the debtor’s beneficial interest under the will for an indemnity against claims under the guarantee made by the creditor after the surety’s death. Parker J. held that it did not. The right of the surety to an indemnity did not become a debt until he (or his estate) had paid the creditor; accordingly the reference to “all debts” in the will did not apply to this future contingent liability which might never accrue. It follows that careful drafting of the will is necessary to avoid frustration of the testator’s intention in such circumstances.

There is a conflict of authority as to whether an executor who is surety for the debt of the testator can exercise a right of retainer from the testator’s estate. In *Re Orme* (1883) 50 L.T. 51, Kay J. held that no right of retainer arose until after payment of the debt by the surety, but he gave the surety the opportunity to make the payment so as to enable him to exercise the right of retainer. In *Re Harrison*

[1886] L.R. 32 Ch. D. 395, the question arose whether the executor could exercise a right of retainer in respect of a debt paid off by him after he had parted with the assets of the testator to a receiver; Pearson J. held that he could not, because at the time when the debt arose there were no assets in his hands against which he could have exercised that right. Again, it was a fundamental part of this decision that the right of retainer could not arise until payment of the debt.

Despite these two cases, in *Re Giles* [1896] 1 Ch. 956, it was held by Kekewich J. that although nothing was due to the executor before he was called on to pay, there was an “equitable debt” which gave rise to a right to retain even before payment. That case was not followed in *Re Beavan* [1913] 2 Ch. 595. Neville J. referred to, and approved of *Re Orme*, and *Re Harrison*. He explained that if the executor has a right in equity to an order, such as that in *Re Orme*, allowing him an opportunity to pay the debt and thereafter exercise his right of retainer, the court might provide for immediate payment of the debt so as to give effect to the right of retainer straight away; but that was quite different from holding that he had a right of retainer before he paid the debt. There was no such thing as an “equitable right to retain”. *Re Giles* was in direct conflict with the earlier authorities and was not in accordance with the underlying principle that a right of retainer only arises on payment of the debt. Accordingly, he declined to follow it. It is likely that in a similar situation today, the court would follow the reasoning in *Re Beavan*.

Payment by surety before the due date

The situation frequently arises in which the surety becomes concerned that the liability of the principal to the creditor is increasing and that he has no immediate means of controlling his potential liability. This is a particular concern when, for example, the director of a company, who has given an unlimited guarantee to a bank for the company’s overdraft, resigns from the company. The guarantee may enable him to terminate it on giving notice to the creditor, which will at least protect him in respect of future liabilities accruing after the notice takes effect, but that does not provide a complete solution to the problem if he does not wish to remain exposed to liability for the indebtedness which has already accrued.

It will be seen below and in the following chapter that there are a number of equitable remedies available to the surety even before he makes payment to the creditor. However, apart from those remedies, once there is default by the principal, or the guaranteed liability crystallises for any other reason, the surety can make payment and look to the principal for reimbursement, without waiting for a claim to be made against him. Payment at that stage will not prejudice his right to an indemnity on the basis that the payment was “voluntary” or premature. If the guarantee is to “pay on demand”, the surety’s right to pay the creditor and seek an immediate indemnity will not be prejudiced if he fails to wait for the demand, even though in such a case the demand is a condition precedent to his liability.³⁴

³⁴ Though the demand will not be a condition precedent if the liability of the surety to the creditor is primary, for example, if the contract is one of indemnity. For example in *Pitt v Purssord* (1841) 8 M. & W. 538, the person claiming a right of contribution was a direct signatory to a promissory note, and therefore a demand was not a condition precedent to his liability on it. See generally the discussion in Ch.7 at 7–002–7–006.

Most cases relating to subrogation will involve the surety claiming to be entitled to enforce securities held by the creditor for the debt which he has discharged. Prior to the decision in *Banque Financiere v Parc (Battersea) Ltd* [1999] 1 A.C. 221 there was some authority to the effect that subrogation is not available in respect of rights which are personal to the creditor. For example, in *Chatterton v McLean* [1951] 1 All E.R. 761, the surety was held not to be subrogated to the hire purchase company's right to seize the goods because, it was held, this was a personal right.²²¹ It has also been held that a right to distrain for rent is not a right to which the surety can be subrogated.²²² However, more modern authorities have deprecated any such limitation on the equitable remedy, at least in cases where in the absence of such a remedy, there would be unjust enrichment. See, e.g. *Cheltenham and Gloucester Plc v Appleyard* [2004] EWCA Civ 291, *The Times*, March 29, 2004, in which Neuberger L.J. said (at [36]):

"Fifthly, although the classic case of subrogation involves a lender who expected to receive security (in the proprietary sense—e.g. a mortgage) claiming subrogation to another security, it can apply to personal rights. In *Re Wrexham, Mold and Connah's Quay Railway Co* [1899] 1 Ch. 440 at 458, Vaughan Williams L.J. referred to the claim for subrogation being to 'the rights of the creditor who has been paid off' and does not appear to have linked those rights to proprietary rights".

That passage was cited with approval by the Court of Appeal in *Filby v Mortgage Express (No.2) Ltd* [2004] EWCA Civ 759, [2004] N.P.C. 98. That case did not concern the rights of a surety to be subrogated to the creditor's rights against the principal debtor but rather, the rights of a lender under an invalid security to be subrogated to the rights of an earlier unsecured lender. A mortgage deed was apparently executed between Mr and Mrs F as mortgagors and the lenders as mortgagees. The lenders' solicitors believed that they were also instructed by Mr and Mrs F, on instructions received from Mr F. The lenders obtained a possession order and, on discovering that Mrs F had abandoned the property, took possession and sold the house. It then transpired that Mrs F's apparent signature on the mortgage application form and mortgage deed was a forgery. Mrs F claimed a full half share in the proceeds of sale, on the grounds that the mortgage was a nullity and she was not bound by it. It was conceded by her (on the principle of *Boscawen v Bajwa* [1996] 1 W.L.R. 328) that the lenders were entitled to be subrogated to the rights of an earlier mortgagee whose mortgage had been discharged by the loan. That left an argument as to whether the lenders were also entitled to be subrogated to the rights of Midland Bank, an unsecured lender, on the grounds that the money advanced by the respondents had also been used to reduce the indebtedness of Mr and Mrs F on joint account to Midland. The lenders succeeded, the Court of Appeal holding that although the classic case of subrogation involves the lender claiming subrogation to another security, it can apply to personal rights, and there

²²¹ *Dalby v India and London Life Assurance Co* (1854) 15 C.B. 365.

²²² *Re Albert Life Assurance Co Ex p. Western Life Assurance Society*, (1870) L.R. 11 Eq. 164.

was no reason in principle not to apply the principles of unjust enrichment as laid down in *Banque Financiere* to this situation. Mrs F was enriched to the extent that the loan reduced her joint indebtedness to Midland. It would be inequitable to leave the lender without a remedy against her. In those circumstances the lender was entitled to a right equivalent to the unsecured personal rights of Midland arising under the joint loan account, including the right to accumulated interest.

Applying the reasoning in those cases, there would appear to be no reason in principle why a surety should not also be entitled to be subrogated to unsecured personal claims by the creditor against third parties, or even against the principal debtor himself.

Rights and securities to which the surety cannot be subrogated

The surety cannot be subrogated in the case of a number of rights and securities: 11-023

- (1) Private insurance policies. The doctrine of subrogation does not extend to a policy on the life of the debtor taken out and maintained by the creditor at his own expense; the creditor may retain the policy even if the principal debt is paid.²²³ Nor will the surety be entitled to be subrogated to an insurance policy taken out by a co-surety at his own expense to protect himself against the liability he might incur under the guarantee.²²⁴ However, a policy of insurance deposited as security for the principal obligation will be subject to subrogation.²²⁵
- (2) Rights wrongfully or preferentially obtained by the creditor. The doctrine of subrogation will not extend to security interests which the creditor has obtained as a result of a voidable transaction. Indeed, it seems that a third party whose property has been charged to the creditor will be permitted to use the guarantee to secure the release of the property, since he will be entitled to have the property relieved of any encumbrance by any property of the principal pledged for the same debt at the expense of the surety for the debt.²²⁶

(1) Transfer of mortgages and other securities

Where the guaranteed debt is secured by a mortgage executed by the principal, the surety is entitled to call for a transfer of the mortgage to himself upon satisfaction of the principal obligation.²²⁷ Prior to the transfer, the surety has an equitable charge on the mortgaged property to the extent of the payment made by the surety.²²⁸ It seems that these rights, although they arise in equity, remain inchoate

11-024

²²³ See *Rainbow v Juggins* (1880) 5 Q.B.D. 422.

²²⁴ *Re Albert Life Assurance Co Ex p. Western Life Assurance Society* (1870) L.R. 11 Eq. 164.

²²⁵ *Re Russell, Russell v Shoolbred* (1885) 29 Ch. D. 254 and see Ch.18.

²²⁶ *Ex p. Altson* (1868) 4 Ch. App. 168.

²²⁷ *South v Bloxham* (1865) 2 Hem. & M. 457, where Page-Wood V.C. appeared to doubt whether the right arose until payment; but see *Dixon v Steel* [1901] 2 Ch. 602, where it was clarified that the surety's rights to security arise when he enters the guarantee; see also *Lake v Brutton* (1856) 18 Beav. 34; *Pledge v Buss* (1860) John. 663.

²²⁸ *Gedye v Matson* (1858) 25 Beav. 310; *Allen v de Lisle* (1856) 3 Jur. N.S. 928; *Re Davison's Estate*, (1893) 31 L.R. I.R. 249.

The rationale for permitting the surety to prove is that the part of the debt guaranteed by the surety is treated, for the purposes of proof, as a separate debt from the part not guaranteed. When the surety pays that part in full, he has fully performed his obligations to the creditor, and becomes subrogated to the creditors' right to prove for that part.⁴⁹ Where the surety pays this amount after the creditor receives the dividend, then it would seem that the creditor stands in the position of a trustee for the surety in respect of the dividend received in the insolvency which would be payable to the surety where he able to prove.⁵⁰

Payment by the surety of the limited maximum under the guarantee

13-010 Where the surety guarantees the whole of the principal debt (as opposed to part) but his liability is limited to a maximum amount, and he pays that maximum amount, then the creditor is entitled to prove for the full amount of the debt in the principal's insolvency without giving a credit for the amount received from the surety, and the surety may not prove in the insolvency for the amount he has paid. It is immaterial that the amount is received before or after the creditor has lodged his proof or received a dividend, since the payment is not payment of the whole indebtedness under the guarantee.⁵¹

In *Re Sass* [1896] 2 Q.B. 12, the surety had guaranteed to the creditor bank the payment of all sums which were then or which might thereafter from time to time become due or owing to the bank from the customer, the principal. The total amount of the surety's liability was not to exceed £300. The guarantee was expressed to be a continuing security for the whole amount due and owing to the creditor bank, in addition to and without prejudice to any other securities which the bank might hold to the account of the principal, and it further provided that any dividends received in the principal's insolvency were not to prejudice the bank's right to recover in full the balance from the surety. The principal became insolvent and the surety, prior to the lodgement of a proof by the bank, paid the £300. The bank nonetheless proved for the full amount of the principal's indebtedness without giving any credit for the sums received: this was challenged by the principal's trustee. Vaughan-Williams J. held that the bank was entitled to prove for the whole amount without deduction.⁵²

⁴⁹ *Westpac Banking Co v Gollin & Co Ltd* [1988] V.R. 397 at 405.

⁵⁰ See para.13-015.

⁵¹ *Re Sass* [1896] 2 Q.B. 12; *Re Rees* (1881) 17 Ch. D. 98; *Re Fernandes Ex p. Hope*, (1843) 3 Mont. D. & D. 720; *Earle v Oliver* (1848) 2 Ex. Ch. 71; *Midland Banking Co v Chambers* (1869) 4 Ch. App. 398; *Seabird Corpn Ltd (In liq.) v Sherlock* (1990) 2 A.C.S.R. 111 at 115-116. *Sugar Hut Brentwood v Norcross*, [2008] EWHC 2634, at [37], Kitchin J.

⁵² This case appears not to have been cited to the Court of Appeal in *MS Fashions Ltd v Bank of Credit and Commerce International SA* [1993] Ch. 425. This may explain Dillon L.J.'s remark (at 448D) that "A creditor cannot sue the principal debtor for an amount of the debt which the creditor has already received from a guarantor". This remark, it is respectfully submitted, should be treated with some caution. See also *Ulster Bank v Lambe* [1966] N.I. 161; *Re Hawkins*, (unreported) February 2, 1978, Walton J. However, Fisher J.'s reasoning in *Stotter v Equiticorp Australia Ltd* [2002] 2 N.Z.L.R. 686 relies on Dillon L.J.'s remark in support of his conclusion that, so far as pre-insolvency receipts from the surety are concerned, the creditor must deduct them from his proof. That *Re Sass* was not cited to the Court of Appeal in *MS Fashions* is a good reason to treat *Stott* with some degree of caution, while retaining admiration for the closeness and thoroughness of the analysis.

In *Barclays Bank Ltd v TOSG Trust Fund Ltd* [1984] A.C. 626, Oliver L.J. suggested (at 644) that a provision that a guarantee is to be in addition to and without prejudice to any other securities held from or on account of the principal and that it is to be a continuing security notwithstanding settlement, is probably sufficient to exclude the surety's right (where it arises) to prove in priority to the creditor in the principal's insolvency. In doing so, Oliver L.J. expressly relied on *Re Sass*. However, in *Re Butlers Wharf Ltd*, [1995] 2 B.C.L.C. 43, Richard Sykes QC considered *Re Sass* and the terms of the guarantee in question in that case. He held that Vaughan Williams J., in concluding that the guarantee was in respect of the whole debt, had not relied upon the words of the guarantee which expressed it to be additional to and without prejudice to any other securities held by the creditor from the principal, rather than the general words expressing the guarantee to be for the whole debt, and the provision that receipt of dividends in the principal's insolvency was not to prejudice the creditor's rights to recover in full from the surety. In *Re Butlers Wharf Ltd* Richard Sykes QC held that the existence of a provision that the guarantee was additional to other security held from the principal, was ineffective to preclude the sureties from being entitled to exercise rights of subrogation and participate in the security rateably with the creditors.⁵³ In reaching his conclusion, he said that it was not necessary to attribute the weight he would otherwise have done to the dictum of Oliver L.J. in *Barclays Bank Ltd v TOSG Trust Fund*.⁵⁴

If the surety pays the limited amount before the principal becomes insolvent, and is then released from further liability by the creditor, there is a view that the creditor will then be restricted to proving only for the balance outstanding from the principal, and the surety will be free to prove for the amount he has paid.⁵⁵ This is, it appears, because the effect of the release is that the surety is no longer liable for the full amount of the debt, and he is treated as having paid the whole of a part of the debt. However, this view has been disapproved in Australia.⁵⁶ In the earlier editions of this work, it was submitted that the better view is that the creditor will not be restricted in the amount of his proof where the guarantee is for the whole debt, even if the surety has paid the amount of his limit before the principal's insolvency. That view must be revisited in the light of the penetrating analysis of the cases by Fisher J. in the High Court of New Zealand in *Stotter v Equiticorp Australia Ltd* [2002] 2 N.Z.L.R. 686. In that case, Fisher J. concluded that a creditor was bound to give credit, in proving in the principal's insolvency, for amounts received from the surety prior to the insolvency date. That view is not

⁵³ By parity of reasoning, the surety would also not be precluded by such a provision from sharing rateably in the dividends in the principal's insolvency: Richard Sykes QC expressly rejected any distinction between sharing in securities and sharing in distribution of the principal's insolvent estate.

⁵⁴ See the valuable critique of this case by Ward and McCormack at (2000) 116 L.Q.R. 121.

⁵⁵ *Mackinnon's Trustee v Bank of Scotland* [1915] S.C. 411.

⁵⁶ In *Westpac Banking Corpn v Gollin & Co Ltd* [1988] V.R. 397, where Tadgell J. (at 406-407) followed Lowry J. in *Ulster Bank v Lambe* [1966] N.I. 161, in which Lowry J. disapproved *McKinnon's Trustee v Bank of Scotland* [1915] S.C. 411. In *Stotter v Equiticorp Australia Ltd* [2002] 2 N.Z.L.R. 686, Fisher J. either distinguished or refused to follow *Westpac* and *Ulster Bank*. There is now therefore, on the current state of the law, a tension between the Australian and the New Zealand authorities on this subject.

credit support on its own terms for the whole deal and the other ECA will generally provide reinsurance.

Facilities available from ECGD

15-006 The types of facility which the ECGD offers have changed in their nature and scope over the years, and the standard forms have been adapted accordingly. In the light of the fairly constant changes and updates, it is unlikely to be helpful or desirable to try to describe in detail in this chapter all the various facilities currently available to suppliers or to overseas buyers, which are set out on the ECGD website.¹³ The ECGD also publishes a number of booklets which are available from its office and which describe the facilities available in considerable detail. A useful overall guide is to be found in "ECGD: A Short Guide to ECGD Facilities". However, it is possible to illustrate the main types of facility which are available, by reference to the medium-term facilities introduced before privatisation of the short-term facilities agency in 1991. In general terms the ECGD facilities complement the private sector, and do not compete with it. Unlike the private sector, however, ECGD does not aim to make a profit from its activities though it does seek to break even. It will therefore pursue a defaulting buyer for full recovery, although some debts may be written off. Following a major review of the "Mission and Status" of the ECGD in 2000 it was concluded that it was not desirable to privatise ECGD's portfolio of medium-term and longer-term facilities because private sector insurers were not willing to take on these risks. Thus if the ECGD stopped offering those facilities, UK exporters would be put at a disadvantage as regards trade competitors from other countries who had the benefit of such support from their own ECAs. Prior to discussing these facilities, we consider the effects of the privatisation and the types of policy which are available from Atradius (formerly NCM) and other short-term risk insurers.¹⁴

Privatisation of part of the ECGD functions

15-007 The EU Commission expressed a clear view that any direct or indirect government involvement in short-term¹⁵ export credit insurance was potentially anti-competitive and in breach of the Treaty of Rome. The 1991 Act therefore made provision for the privatisation of the limb of ECGD, based in Cardiff, which had been dealing with such insurances. In December 1991, Britain became the first member of the European Union to privatise its short-term export credit agency. It sold the business to a privately owned Dutch credit insurer named Nederlandse Credietverzekering Maatschappij NV, which set up a subsidiary, NCM Credit Insurance Ltd (NCM) to administer the run-off on existing short-term guarantees

¹³ <http://www.ecgd.gov.uk>. The ECGD helpline is to be found at help@ecgd.gsi.gov.uk, Tel. 020 7512 7887.

¹⁴ A more detailed description is to be found in *Benjamin's Sale of Goods* (8th edn, 2010), Ch.25, and in Jones, "Some Legal Aspects of Political Risk Insurance" *Project Finance Yearbook 1994/95* (Euromoney Publications), pp.73-75, but potential applicants should contact ECGD or look at its website which is <http://www.ecgd.gov.uk> or the websites of one of the relevant private sector insurers: <http://www.atradius.co.uk>; <http://www.eulergroup.com> or <http://www.coface.uk.com> in order to obtain up-to-date information about the facilities on offer.

¹⁵ Less than two years.

issued by ECGD and to issue new policies in its own name on similar terms to those which ECGD previously offered. NCM changed its name to "Atradius" in 2004, following a shareholder restructuring.

NCM (now Atradius) took over most of the existing Cardiff personnel and therefore acquired the benefit of the existing ECGD expertise. Initially it adopted the style and wording of the existing ECGD documents, but it gradually replaced them with newer-style "plain English" policies. The privatisation appears to have been a success. Atradius is now one of the world's largest trade credit insurers and had a reported turnover of €1.5 billion in 2010. Atradius offers a range of different products including Modula Credit Insurance (to cover against non-payment by customers both at home and abroad), Modula Focus Credit Insurance (a policy for companies with a turnover of up to £10 million, that allows selection of the customers that the assured wishes to cover, whether export, domestic, or both); Global Credit Insurance for multinational businesses, and special products that can be tailored to individual needs.¹⁶ There are other private sector insurers offering cover similar to that on offer from Atradius, for example, in the UK, Euler Hermes UK Plc and Coface UK.

As with medium-term and long-term facilities, the insurance will only cover a proportion of the loss (generally between 90 and 95 per cent) and the customer will have to bear the risk of the uninsured percentage. There may also be a specific credit limit placed on transactions with a particular buyer. Premiums are assessed and fixed in the same way as any other insurer would do, with higher premiums (called Market Rate Additions or MRAs) being charged for contracts involving those markets which are perceived as a higher risk. A small annual administration charge is also made.

Facilities offered by ECGD

Export Insurance Policies

ECGD will issue an Export Insurance Policy (EXIP) to an exporter from the UK on a case-by-case basis. Such policies insure against the risk of non-payment under an export contract or against not being able to recover the cost of performing that contract because of certain events which prevent its performance or lead to its termination. Since they are negotiated individually the risks covered may be commercial, political or both, and the premium will depend on the assessment of the risk in the individual case. ECGD also offers supplementary policies, such as the Bond Insurance Policy referred to in para.15-010 and other facilities which are described in detail on the ECGD website. Apart from the one-off facilities, ECGD also offers the Supplier Credit Facility (SCF) discussed in para.15-009. This is the only comprehensive facility which is still available from ECGD. The EXIP, as its name implies, is an insurance policy¹⁷ under which ECGD agrees to

15-008

¹⁶ For a more detailed description of the types of policy available from Atradius, see Benjamin, (8th edn, 2010), paras 25-017-25-024.

¹⁷ A predecessor, a "Comprehensive Guarantee (Shipments)", which covered the supplier's exports to Brazil, was held to be a contract of insurance rather than a guarantee by Wynn-Parry J. in *Re Miller, Gibb & Co.*, [1957] 1 Lloyd's Rep. 258. Subsequent versions of this type of facility, including the "suppliers' credit policy" which was the subject of *Lucas (L) v Export Credits Guarantee Department*

money paid under the bonds can be used to enable the project to be completed, without the employer or principal contractor having to find money from his own resources. In many construction contracts, performance bonds are also used as a means of ensuring that the timetable for completing the project is adhered to, or that advance payments made to the contractor are repaid if he defaults in his obligations. Thus, for example, part of the price, known as retention money, which is to be retained under the contract until the work is certified as completed and all the maintenance obligations of the contractor are fulfilled, may be released in whole or in part to the contractor against a bond which secures its repayment to the employer should the contractor then fail to complete the work.

International sales

16-005 Similar considerations apply in international contracts for the sale of goods. The buyer, who often buys the goods unseen, and yet is usually obliged to pay by means of a letter of credit, will use the bond as a safeguard against late delivery, non-delivery or delivery of goods which are not in accordance with the contractual specification, as well as protection against fraud. His right of recourse to a performance bond may be particularly important if he has sold the goods on back-to-back terms, or needs them to fulfil a particular project or contract which is subject to time limits. If the buyer is a government, or a state-owned entity, the supplier will almost invariably have had to bid for a tender, and, as with construction contracts, the government will be concerned to ensure that the supplier performs the contract in conformity with the tender. Consequently, performance bonds are almost invariably required in such contracts.

In its briefing note on the previous version of the Uniform Rules for Demand Guarantees (ICC publication No.458, discussed in para.16-019) the ICC identified the main uses of performance bonds in international commerce as follows:

1. Tender or bid guarantee—This is to safeguard the party inviting the tenders against the withdrawal of a tender after the tender closing date from or the non-signing of the resulting contract by the successful tenderer. It is also provided to safeguard against the successful tenderer signing the contract, but not providing the agreed performance guarantee.
2. Performance guarantee—A performance guarantee is to safeguard the importer against the consequences of non-performance of the contract by the exporter.
3. Advance payment guarantee—An advance payment guarantee is to safeguard the importer against giving an advance payment and the exporter subsequently failing to perform the contract.
4. Retention guarantee—A retention guarantee safeguards the importer against the early release of retention moneys (required as a form of warranty security), as opposed to stage payments, and the exporter failing to perform what remains of the guarantee.

5. Warranty guarantee—A warranty guarantee safeguards the importer against the non-performance of the warranty by the exporter.

The advantages of performance bonds

Comparative cost

16-006 Although it may be possible to insure against the contingencies which would trigger payment under the performance bond, insurance is often a more expensive option. The charges made by the bank issuing the performance bond may be comparatively small, reflecting the fact that the bank should not have to become involved in an investigation of the factual basis for any demand made against it, or in any litigation between the account holder and the beneficiary if the demand was allegedly unjustified. These lower charges may be favourably reflected in the price of the goods or services to be supplied under the underlying contract, although the account party may need to adjust the price in order to reflect the degree of risk of an unjustified or dishonest claim being made against the bond.²⁶ Of course, his practical ability to reflect that risk in the price may be curtailed by other commercial considerations, especially if he is bidding for a tender against numerous competitors.

Obtaining immediate payment

16-007 An insurer may also take much longer to pay even a fairly straightforward claim under the insurance contract than a bank will take to pay under a performance bond. In the case of the archaic forms used by the construction industry, insurers issuing bonds tend to be more enthusiastic about resisting payment than banks. This is possibly due to the fact that a bank will invariably require the account party to furnish back-to-back security for the full amount, whereas the premium demanded by the insurer could be substantially lower than the potential outlay to which he is exposed. The insurer under an insurance contract or who issues that type of bond also has more potential scope for resisting payment, as does a genuine surety, whereas, as the case law demonstrates, it is generally extremely difficult to resist or to prevent payment under normal performance bonds. This gives the beneficiary the advantage that he will obtain payment before any underlying disputes are determined, which naturally strengthens his bargaining position.

In *Bolivinter Oil SA v Chase Manhattan Bank NA* [1984] 1 W.L.R. 392 at 393, Sir John Donaldson M.R. observed of irrevocable letters of credit and performance bonds or guarantees:

“The unique value of such a letter, bond or guarantee is that the beneficiary can be completely satisfied that whatever disputes may thereafter arise between him and the bank’s customer in relation to the performance or

²⁶ See, e.g. the observations of Geoffrey Lane L.J. in *Edward Owen Engineering Ltd v Barclays Bank International Ltd* [1978] 1 Lloyd’s Rep. 166 at 174 and of Ackner L.J. in *United Trading Corp SA v Allied Arab Bank Ltd* [1985] 2 Lloyd’s Rep. 554 at 566.

only sign such a statement if the creditor has permission under Pt 4 of the Financial Services and Markets Act 2000 to accept deposits. A person who is of "high net worth" is someone who, during the previous financial year (being the year ending March 31, preceding the current financial year in which the statement is made) had a net income of at least £150,000, or assets in excess of £500,000.⁵ Schedule 2 sets out the form of a statement of high net worth and Sch.1 sets out the form of the declaration to be signed by the person of high net worth. Schedule 3 sets out the form of declaration for exemption relating to businesses. It is important to note that the new provisions relating to unfair relationships, which replace the provisions for re-opening "extortionate credit bargains", will continue to apply to such agreements (and to any security provided in respect of them) even though they are otherwise exempted from regulation. This is spelled out in the statutory declarations. The protection they afford to such individuals is likely to be limited: for example, in *Fahad al Tamimi v Mohamad Khodari* [2009] EWCA Civ 1109, the Court of Appeal upheld the decision of Blair J. [2008] EWHC 3065 (QB) that a banker who had personally lent money to a wealthy businessman who was a compulsive gambler, on terms that he should be repaid the outstanding sums plus 10 per cent, was entitled to enforce the bargain. There was nothing unfair about the parties' relationship that would justify a discharge or reduction of the profit element under s.140B of the Act; the Court of Appeal not only placed weight on the judge's findings on the evidence that a 10 per cent fee for making an unsecured loan to a foreign borrower was fairly normal, but regarded it as crucial that there was no evidence that at any point prior to the loans the defendant had questioned the fee or sought to make less expensive arrangements for the funding of his gambling habit.

The 1974 Act, as amended, imposes a system of licensing on persons carrying on a business which involves the making of consumer credit and consumer hire agreements, and on those who supply ancillary credit services. It also specifies the form and content which such agreements must take, and requires certain information to be disclosed to the debtor, hirer or surety in respect of such an agreement or a "linked transaction".⁶ As a result of the amendments introduced by the 2006 Act, the Act imposes new obligations on creditors to give debtors under regulated fixed sum or running account agreements notices of arrears, in a specified form, at regular prescribed intervals (ss.86A–86D). The sanction for non-compliance is that the creditor will be unable to enforce the agreement during the period of failure and interest will cease to run during that period. For all regulated agreements other than "non-commercial" or "small" agreements as defined in the Act, a new regime is also introduced for the service of notices in a prescribed form whenever a default sum (a sum other than interest payable by the debtor or hirer on default) becomes payable. Section 86E precludes the creditor from charging

⁵ These are the financial limits currently specified in the Order, and may be subject to change in the future.

⁶ As defined by s.19(1). For example, if a finance company has pre-existing arrangements with a car dealer, and the dealer puts the debtor in touch with the finance company, which then makes him a loan to enable him to buy the car, the contract of sale is a linked transaction. Contracts of suretyship are not "linked transactions" but they are covered by other specific provisions in the Act.

anything other than simple interest on a default sum. The Act also regulates the withdrawal from, and cancellation and termination of such agreements, and the steps which must be taken by the creditor before enforcing any security.

The protection of sureties for consumer agreements

The Act was the first attempt by the legislature to provide a coherent pattern of rules governing the taking and enforcement of security in respect of consumer credit and consumer hire agreements. The protection which it provides does not derogate from any other rights and remedies which may be available to the surety at common law or in equity. The principal areas of control provided for by the Act and regulations made under it can be summarised as follows: 17-002

- (1) Certain documents and information are required to be supplied by the creditor to prospective and actual sureties, in a specified and readily comprehensible form; the objective is to ensure so far as is possible that the surety knows precisely what obligations he is guaranteeing, and what his rights and obligations are.
- (2) The form and content of security instruments (i.e. documents containing a guarantee or indemnity provided in relation to a regulated agreement)⁷ are specified: again the objective is to set out all the rights and obligations of the parties in clear and readily comprehensible terms.
- (3) The Act provides a system of control over the realisation and enforcement of securities, and provides that in certain circumstances the securities will be treated as invalid and ineffective.
- (4) It applies the principle of co-extensiveness to all contracts of suretyship in respect of regulated agreements, and prevents evasion of the system of regulation and control by the device of taking security for the principal's obligations either from the principal or from a third party.

In addition to these main areas of control, the Act also contains special provisions which relate to pledges, and restricts the taking and negotiation of negotiable instruments in connection with a regulated agreement. These matters are outside the scope of this work.

Protected sureties

The Act adopts an extremely wide definition of a "surety" in s.189(1): 17-003

"Surety means the person by whom any security is provided, or the person to whom his rights and duties in relation to the security have passed by assignment or operation of law."

⁷ s.105(2), and see para.17-004.

demonstrated that he regards the lease as ended for all purposes. His conduct is inconsistent with there being a continuing liability on others to perform the tenant covenants in the lease. He cannot have possession of the property and, at the same time, claim rent for the property from others."

Although Lord Nicholls was specifically directing his remarks to the obligation to pay rent, the obligation of the surety to take on a new lease is integrally linked to the obligation to pay rent. The taking on of the new lease has been described as a means of giving effect to the surety's obligation to procure compliance with the terms of the old lease: see *Coronation Street Industrial Properties v Ingall Industries Plc* [1989] 1 All E.R. 979 at 981, per Lord Templeman. If that is so, then the retaking of possession by the landlord is just as incompatible with the enforcement of an option to require the surety to execute a new lease, as it is with requiring him to pay rent under the old one.

- (2) The retaking of possession after a disclaimer is also inconsistent with requiring a new lease to be taken as from the date of the disclaimer, as it would be peculiar if the landlord could be entitled to charge rent for a period during part of which he had possession of the property.
- (3) Section 178(4)(b) of the Insolvency Act 1986 suggests that there should be no difference in principle between the effect of repossession before and after a disclaimer on the relationship between landlord and surety.
- (4) The conclusion would not do violence to the language of the usual form of covenant, because the "guarantor" must still be a "guarantor" when the option is sought to be enforced against him;
- (5) The Court of Appeal in *Basch v Stekel* [2001] L. & T.R. 1 proceeded on the assumption that the landlord could not enforce the option if he took possession after a disclaimer.

A further argument deployed by the sureties in *Active Estates Ltd v Parness* was that the clause requiring them to take up a new lease was unenforceable because the provisions of s.2 of the Law of Property (Miscellaneous Provisions) Act were not complied with. Although the contract creating the option in favour of the landlord was in writing and signed by the surety, it was argued that the contract arising as the result of the exercise of that option was not recorded in writing, and that therefore the provisions of the Act were not satisfied. However, Neuberger J. held that the statute was sufficiently complied with if the grant of the option was evidenced in writing and signed by the surety.

In practice, it may be difficult for the surety to prove that the landlord has accepted the surrender of the old lease or taken possession. For example in *Bhogal v Cheema* [1998] 2 E.G.L.R. 50 the landlord accepted rent from an associated company of the tenant company, which then went into liquidation. When the landlord made a demand on the surety for payment of the arrears of rent, it was held that there was no implied surrender of the old lease by the insolvent tenant, and no implied acceptance of surrender by the landlord in allowing the associated

company into possession and accepting rent from it, since the landlord had made it clear that it regarded any payments by the associated company as being payments for the account of the tenant. Sir John Vinelott also held that there was no obligation on the landlord to mitigate his loss by taking possession of the property—it was up to the surety to seek a vesting order if he wished to mitigate his own position. Likewise, in *Active Estates Ltd v Parness* (above) the sureties were unable to establish on the evidence that the landlord had taken possession of the property after the disclaimer, although again the landlord had allowed an associated company of the insolvent tenant to occupy the premises. The landlord had agreed, prior to the disclaimer, to grant the associated company a right of occupation upon disclaimer. However, that right of occupation was in the nature of a licence, and all rent demands continued to be addressed to the insolvent company.

Disclaimer on insolvency of a sub-tenant or assignee of the lease

The decision in *Hindcastle* finally put paid to the apparent anomaly between the position of the original tenant and the guarantor, when the disclaimer was by the trustee or liquidator of an assignee of the lease. It had been established long before *Stacey v Hill* that disclaimer by an assignee's trustee in bankruptcy did not release the original tenant from his obligation to pay the rent: *Hill v East & West India Dock Co* (1883–84) L.R. 9 App. Cas. 448, applying *Ex p. Walton*, (1881) L.R. 17 Ch. D. 746. The obligations of the original tenant are primary, and not secondary, so the requirement that the insolvent party's obligations should survive did not apply to the tenant. However, if the lease was terminated by the disclaimer, it would be difficult to see how any future rent could be claimed from anyone. Moreover, the much-criticised second ground for the decision in *Stacey v Hill*, namely that it was "necessary" to release the surety from liability in order to release the insolvent estate from its liability to indemnify him, applied equally to tenants, who would also have a right of indemnity. The Court of Appeal in *Stacey v Hill* had sought to distinguish the earlier authorities on the basis of the wording of the Bankruptcy statute which was in force at the time when they were decided, but it was apparent that the decisions could not easily be reconciled.

It was another 77 years before the position of the original tenant (and any surety for his obligations) fell to be considered by an English court in the light of *Stacey v Hill* and the changes in wording of the Bankruptcy legislation since *Hill v East & West India Dock Co* was decided. It was considered in the interim in New Zealand by McGregor J. in *Re Ice Rinks (Timaru) Ltd*, [1955] N.Z.L.R. 641 and Australia by Gowans J. in *Re Teller Home Furnishers Pty Ltd (In Liquidation)*, [1967] V.R. 313, which concerned statutory provisions which were identical to the corresponding terms in the English statute. In both cases it was decided that the obligations of the original tenant survived the disclaimer; in the latter case Gowans J. also, somewhat reluctantly, followed *Stacey v Hill* and held that the sureties for the obligations of the assignee to the landlord were discharged. The question finally came before Sir Robert Megarry V.C. in *Warnford Investments v Duckworth* [1979] 1 Ch. 127. Somewhat surprisingly, neither of these Commonwealth authorities was cited to the court. Nevertheless, Megarry V.C. reached the same conclusion as McGregor J. and Gowans J. that the obligations of the original tenant survived the disclaimer despite