intended to enjoy. Although this part of the judge's reasoning would not apply to a case in which the sealing formalities had not been observed by the normal type of company guarantor, who does not receive payment for standing surety, the first ground on which he rejected the defendant's argument would hold equally good in that context. The judge also held that even if he was wrong on this point, and the seal could not be relied upon, the signature of the bond by two directors, one of whom was also the company secretary of WME, would have been sufficient in the alternative to demonstrate compliance with the formal requirements of s.36A of the 1985 Act.[51]

Of course, if an otherwise complete contract of guarantee was intended to be embodied in a deed, but the formalities have not been complied with, the creditor can still enforce the agreement. For example, in *Lloyds TSB Plc v Dye House Ltd* [2005] EWHC 1998, W, the alter ego of a group of five companies, had signed an "omnibus" guarantee in respect of a facility afforded by the Bank to those companies at his request. The guarantee required another signature in order to make it effective as a deed. The judge, Mr Simon Brown QC, granted summary judgment on the basis that, although the guarantee was not a deed, W had sought a facility for his companies which the bank had provided in consideration of his promise to guarantee repayment. Consequently a contract had arisen which the Bank was entitled to enforce.

The guarantee will also be effective if the deed purports to have been executed by the surety in the presence of a witness who, in fact, signs it on a later occasion: *Shah v Shah* [2001] EWCA Civ 527 at [30]–[31], applied in *Dunbar Assets Plc (formerly Dunbar Bank Plc) v Lenney* [2014] EWHC 2733 (Ch). As Norris J explained in the latter case at [21]:

> "in the context of what is effectively a document of Guarantee, there is no social policy which requires the person attesting the signature to be present when the document is signed. Challenges to the signature of the deed by the witness should not permit a person to escape the consequences of an apparently valid deed which they signed containing a representation that it was signed in the presence of an attesting witness by challenging that the witness was not present."

[51] Now s.44 of the Companies Act 2006.

CHAPTER 3

Formal Requirements

THE STATUTE OF FRAUDS 1677

The Statute of Frauds 1677 s.4 provides that: **3-001**

> "[N]o action shall be brought … whereby to charge the defendant upon any special promise to answer for the debt, default or miscarriages of another person … unless the agreement upon which such action shall be brought or some memorandum or note thereof shall be in writing and signed by the party to be charged therewith or some other person thereunto by him lawfully authorised."

Introduction

3-002 The Statute of Frauds was enacted in order to meet a danger perceived by the legislature that certain types of contract could be established by false evidence or "by evidence of loose talk, when it never was really meant to make such a contract": per Lord Blackburn in *Steele v McKinlay* (1879–80) L.R. 5 App. Cas. 754 at 768. It appears that over three centuries later, this danger is still perceived as being sufficiently prevalent in the modern commercial climate to justify retaining the rule. Section 4 of the Statute of Frauds originally applied to five classes of contract, but it was replaced by other legislation in the case of contracts for the sale or other disposition of land.[1] In 1937, the Law Revision Committee[2] recommended the repeal of s.4, but a minority headed by Goddard J dissented in relation to guarantees, and no action was taken by Parliament at that juncture. In 1953, the Law Reform Committee,[3] whilst endorsing the recommendation of its predecessor that s.4 should be largely repealed, unanimously recommended that it should continue to apply to guarantees. The repeal in respect of the remaining three classes of contract was effected by the Law Reform (Enforcement of Contracts) Act 1954.

The main reason given by the dissenting minority in 1937 for retaining the requirement of writing for contracts of guarantee (which was endorsed by the subsequent Law Reform Committee) was that there was a real danger of inexperienced people being led into undertaking obligations which they did not fully understand, and that opportunities would be given to the unscrupulous to assert that credit was given on the faith of a guarantee which the alleged surety had no intention of giving. A guarantee was said to be a special class of contract, being generally one-sided and disinterested as far as the surety was concerned (in the vast

[1] Section 40 of the Law of Property Act 1925, since superseded by s.2 of the Law of Property (Miscellaneous Provisions) Act 1989.

[2] *Sixth Interim Report, Statute of Frauds and the Doctrine of Consideration*, Cmd. 5449.

[3] *First Report, Statute of Frauds and s.4 of the Sale of Goods Act 1893*, Cmd. 8809. Similar legislation is in force in most Commonwealth jurisdictions, including Canada, except for Manitoba where it was repealed in 1982. See K. McGuinness, *The Law of Guarantees*, 3rd edn (LexisNexis, 2013), para.5.7.

majority of cases, the surety was getting nothing out of the bargain) and the requirement of writing would ensure that the terms of the guarantee were settled and recorded. The view was also expressed that the requirement of writing would give the proposed surety an opportunity for thought.

Despite its laudable aim, the Statute of Frauds has proved in practice to be used more often as a weapon for the unscrupulous, than as a protection for the innocent. As a result, there have been hostile judicial observations about the statute almost from the time of its enactment. Despite this, many years after the latest decision was made by Parliament in 1953 to retain the requirement of writing for guarantees, the policy behind the requirement continues to receive occasional judicial commendation. For example, in *Autocar Equipment Ltd v Motemtronic Ltd and Searle* unreported CAT No.656 of 1996, June 20, Henry LJ said (at pp.24–25 of the transcript):

> "I have made it clear that in my judgment the mischief aimed at by Section 4 of the Statute of Frauds 1677 remains as valid as ever it did … This matter seems to me to be one of practical importance. Where there is an oral promise to answer eventually for the legal default of another the precise wording of that oral promise will often be difficult to ascertain, and often an uncertainty will lie over it even after the Court has found what the words used were. The result may often be commercially improbable and the requirement of a written note or memorandum should operate to make sense of the agreement."

In *Technology Partnership Plc v Afro-Asian Satellite Communications (UK) Ltd* unreported CAT No.1588 of 1998, there was a divergence of views on the question whether s.4 was still an appropriate form of safeguard. The issue in the appeal was whether two letters written on company notepaper by C, described as the "moving spirit" behind a group of companies, constituted sufficient memoranda of an oral guarantee given by C in respect of the indebtedness of one of the companies to the plaintiff. The Court of Appeal held that they did not. Peter Gibson LJ said that it was a decision which he reached with some regret, and that it was unfortunate that by reason of s.4 of the Statute of Frauds, C escaped the possibility of being held personally liable for his word:

> "I would for my part question whether today it is still necessary to give such special protection to those who give guarantees … It may well be that some protection is required for guarantors such as the possibility of being able to escape the guarantee within a limited period. But it does seem to me to be arguable that the sanction contained in s.4 is out of all proportion to the mischief which it was originally intended to combat."

Pill LJ, however, disagreed. He said:

> "For my part, I see a practical purpose in the existence of safeguards for those alleged to be guarantors … I am not persuaded by anything in this case that it would in modern conditions be safe or appropriate to permit a contract of guarantee to be established merely by oral evidence."

When the House of Lords considered the policy behind s.4 in the more recent case of *Actionstrength Ltd (t/a Vital Resources) v International Glass Engineering IN.GL.EN SpA* [2003] 2 A.C. 541,[4] the majority appeared to agree with Peter Gibson LJ's view. Regret was expressed that a party, making and acting on what was thought to be a binding oral agreement, would find his commercial expectations defeated when the time for enforcement came and the other party successfully relied upon the lack of a written memorandum or note of the agreement. Lord Bingham (with whom Lord Woolf and Lord Walker agreed) said at [7]:

> "It may be questionable whether, in relation to contracts of guarantee, the mischief at which section 4 was originally aimed is not now outweighed, at least in some classes of case, by the mischief to which it can give rise in a case such as the present, however unusual such cases must be. But that is not a question for the House in its judicial capacity."

[4] Discussed further in paras 3-006 and 3-031.

In that case, the defendant, SG, had entered into a contract with I as main contractor for the construction of a factory in Yorkshire for the manufacture of float glass. The claimant, A, was a recruitment agency engaged by I as a sub-contractor to provide labour for the project. I fell seriously into arrears in the payment of A's invoices, and A threatened to withdraw all labour from the site unless the arrears were paid. A held various meetings with representatives of SG, to try to find a solution. A alleged that in the course of those meetings it was agreed by SG that if A did not withdraw its workforce from the site, if I then failed to pay A any sums which were or became owing to it, SG would redirect sums which were due to I from SG to settle A's invoices. A acted on that assurance. However, after about another month of work on the site, the indebtedness of I to A had increased significantly. A terminated the contract with I and withdrew the workforce. It then sued both I and SG, but I went into liquidation.

SG sought summary judgment against A on the basis that, even if there had been an agreement in the terms alleged by A, that agreement was a guarantee, and because it was made orally and there was no written record of it, it was unenforceable by virtue of s.4 of the Statute of Frauds. The judge (Mitting J) refused the application on the basis that the alleged agreement was an indemnity, but the Court of Appeal (Simon Brown, Peter Gibson and Tuckey LJJ) [2002] 1 W.L.R. 566 reversed him on that point, whilst acknowledging that it was an interesting and not entirely easy issue.[5] They also held that s.4 of the Statute of Frauds was a complete answer to A's claim because the facts did not give rise to an arguable estoppel. The case went to the House of Lords on the estoppel point, and the decision of the Court of Appeal was upheld, notwithstanding the apparent injustice to A if A's version of events was correct.

As Lord Bingham pointed out at [5], the reasons given by the dissenting minority of the Law Revision Committee for retaining the rule in relation to conventional consumer guarantees had little bearing on a case such as this. This was not a bargain struck between inexperienced people, liable to misunderstand what they were doing: "these were not small men in need of paternalist protection". SG had a clear incentive to enter into the agreement and, on the assumed facts, had time to think again before committing itself. Moreover, SG had something to gain from the bargain. The termination of A's contract with I would have been seriously prejudicial to SG, whose interest was to take expeditious possession of a completed factory. SG received the benefit of the work done by the labour which A supplied over the weeks that followed the alleged agreement, and the indebtedness of I to A increased five-fold over that period. Moreover, it was doubtful whether those who made the assumed agreement appreciated that it was in law a guarantee. In those circumstances, it is hardly surprising that little enthusiasm was expressed for the outcome of the appeal by three members of their Lordships' House.

By contrast, Lord Clyde and Lord Hoffmann forbore to express any view about whether the policy behind the statute was justifiable in modern times. Lord Hoffmann acknowledged that if a judge found A's version of events to be correct, to hold the promise unenforceable would certainly appear unfair: morally, there would be no excuse for SG not keeping its promise. However, although there was a natural inclination to try and find some way in which the putative injustice could be avoided, it was important to bear in mind that the purpose of the statute was

[5] See the discussion in para.3-006.

precisely to avoid the need to decide which side was telling the truth about whether or not an oral promise had been made, and exactly what had been promised. Parliament decided that there had been too many cases in which the wrong side had been believed, and a strong Law Reform Committee had recommended the retention of the rule in 1953. He said (at [20]):

> "The terms of the statute … show that Parliament, although obviously conscious that it would allow some people to break their promises, thought that this injustice was outweighed by the need to protect people from being held liable on the basis of oral utterances which were ill-considered, ambiguous or completely fictitious. This means that while normally one would approach the construction of a statute on the basis that Parliament was unlikely to have intended to cause injustice by allowing people to break promises which have been relied upon, no such assumption can be made about the statute … it must not be construed in a way which would undermine its purpose."[6]

It remains to be seen whether a future Law Reform Committee will adhere to the views of its illustrious predecessors, or whether it will recommend either the complete abolition of the rule, or a modification to restrict the statutory protection to those (such as consumers) who may be perceived to be still in need of it.[7]

The recognition that the statute can operate unfairly to deprive a creditor of his legitimate commercial expectations also gave rise to ingenious attempts by litigants to circumvent it. In the early years after its enactment, one method particularly favoured was to treat the surety's oral promise to be answerable for another as a false representation as to credit for which he was liable in tort: see, e.g. *Pasley v Freeman* (1789) 3 Term Rep. 51. However, this was stopped by the passing of the Statute of Frauds Amendment Act 1828 (Lord Tenterden's Act) s.6, which prevented representations of this kind from being actionable unless made in writing.[8]

Although attempts to circumvent the operation of the Statute of Frauds have been frowned on subsequently,[9] the courts will be vigilant to prevent it from being misused. As Lord Birkenhead observed in *United States v Motor Trucks Ltd* [1924] A.C. 196 at 200: "the Statute of Frauds is not allowed by any court administering the doctrines of equity to become an instrument for enabling sharp practice to be committed". In *Steadman v Steadman* [1976] A.C. 536 at 558 this observation was echoed by Lord Simon in the context of a discussion of the doctrine of part-performance, when he said that "[e]quity would not, as it was put, allow the Statute of Frauds 'to be used as an engine of fraud'". The extent to which principles of equity may be used in guarantee cases to meet a defence of non-compliance with s.4 is discussed in paras 3-030–3-032 below.

In practice, most contracts of suretyship which are entered into in a commercial

[6] This passage has been referred to and applied in a number of subsequent cases including, for example, *Golden Ocean Group Ltd v Salgoacar and others* [2012] EWCA Civ 265; [2012] 1 W.L.R. 3674 per Tomlinson LJ at [6].

[7] In Hong Kong, the statutory provision which introduced s.4 of the Statute of Frauds into domestic law was repealed in 1972. Oral contracts of guarantee are therefore enforceable in that jurisdiction: see e.g. *Global Bridge Assets Ltd and others v Sun Hung Kai Securities Ltd* [2009] HKCFI 309 at [29]. By contrast, the equivalent statutory provision in New Zealand, s.27 of the Property Law Act 2007, has moved to the opposite extreme. It stipulates that a contract of guarantee must be in writing and signed by the guarantor. This requirement is stricter than s.4 of the Statute of Frauds (as reflected in earlier New Zealand legislation) since a memorandum or record of the oral agreement will no longer suffice and the contract must be signed by the guarantor himself, in the capacity of guarantor. A failure to comply with the statutory requirement no longer affects enforceability; it renders the guarantee a nullity: *Northcott v Davidson* [2012] NZHC 1639.

[8] See generally *Halsbury's Laws* (2008), Vol.49, para.1054.

[9] See, e.g. the observations of Pollock CB in *Mallett v Bateman* (1865–66) L.R. 1 C.P. 163 at 170–171.

context are either made in writing or made orally and confirmed in writing, and thus the number of cases in which a defence based on s.4 of the Statute of Frauds has been raised successfully has decreased in recent years. Nevertheless the statute can still prove to be a pitfall for the unwary creditor. A further modern illustration is the case of *Deutsche Bank v Ibrahim* [1992] 1 Bank. L.R. 267. The principal was required by the plaintiff bank to provide security for an overdraft facility. He therefore deposited with the bank the title deeds to some flats which he had purchased but which were registered in the names of his daughters. The bank sought a declaration that there was a valid equitable mortgage; the daughters successfully counterclaimed delivery up of the title deeds. The court held that the deposit was made by way of guarantee of the repayment of the loan to the father, and that therefore, as there was no memorandum signed by the daughters complying with the requirements of s.4 of the Statute of Frauds, the bank's claim was unenforceable.[10]

Contracts to which section 4 applies

"Special promise"

A "special promise" means an express promise, and does not include implied promises which arise by operation of law: *Gray v Hill* (1826) Ry. & M. 420. It is not confined to promises made in contracts under seal or of record: *Holmes v Mitchell* (1859) 7 C.B. N.S. 361 at 368–369. Indeed, such a restriction would render the statute meaningless. **3-003**

"Debt, default or miscarriage"

Each of these words has a distinct legal meaning; together they would appear to cover any form of legal liability. A "debt" is a past contractual liability: *Castling v Aubert* (1802) 2 East 325 at 330–331 per Lord Ellenborough CJ. A "default", however, is probably wide enough to encompass a future liability including a non-contractual liability: see *Kirkham v Marter* (1819) 2 B. & Ald. 613. Even if "default" is not that wide, the word "miscarriage" would appear to encompass any other form of civil liability (*Kirkham v Marter* per Abbott CJ at 616). Accordingly, an agreement between S and C that if D does not pay compensation to C for a tort committed by D, S will make payment of that compensation, prima facie falls within the terms of the statute. On the other hand, an agreement by a surety to answer for the non-performance by the principal of his obligations to another will not be a guarantee if on its true construction, his liability arises even if the non-performance is not a breach of contract. See, e.g. *Northwood Development Co Ltd v Aegon Insurance Co (UK) Ltd* (1994) 10 Const. L.J. 157, where the underlying contract terminated automatically upon the principal (a contractor) going into liquidation, and his continuing non-performance which triggered the obligation to pay was therefore not a breach. **3-004**

"Another person"

Although the words "debt default or miscarriages of another person" are wide enough to cover all types of contract of suretyship (indemnities also involve one **3-005**

[10] A mortgage can no longer be created in this way, by virtue of the provisions of s.2 of the Law of Property (Miscellaneous Provisions) Act 1989: see, e.g. *United Bank of Kuwait Plc v Sahib* [1997] Ch. 107 CA.

person becoming responsible for the debts of another) it was established from a very early date that the section only applies where there is some person other than the surety who is primarily liable to the creditor, i.e. where it is a guarantee in the true sense.[11] It does not apply to a contract where the surety assumes a primary liability, or to a contract where the promise is made to anyone other than "the person to whom another is already or is to become answerable".[12] It will apply both to a guarantee and to a binding agreement to give a guarantee.[13]

The statute does not apply to a contract under which, on true analysis, the surety is promising to pay his own debt and not the debt of another.[14] Examples of such contracts include an agreement to pay a sum by way of compromise of a claim made against the promisor and third parties (even though the promisor may have had a good defence to the claim against him)[15]; a promise to be answerable for payments due from the promisor's own agent (for whose default he would be vicariously liable)[16]; a promise to pay money owed by the promisor to the promisee in satisfaction of the promisee's indebtedness to a third party[17]; a promise to be answerable for a debt only to the extent of the promisor's own indebtedness to the creditor[18]; 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.[19]

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.[20] 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

[11] *Birkmyr v Darnell* (1805) 1 Salk. 27, 91 E.R. 27; *Lakeman v Mountstephen* (1874) L.R. 7 H.L. 17; *Harburg India Rubber Comb Co v Martin* [1902] 1 K.B. 778 CA. See also the cases cited in Mackay (ed.), *Halsbury's Laws* (2008), Vol.49, para.1058, fn.2.

[12] per Vaughan Williams LJ in *Harburg India Rubber Comb Co v Martin* [1902] 1 K.B. 778 at 784, and see below.

[13] *Mallett v Bateman* [1865] L.R. 1 C.P. 163; *Compagnie Générale d'Industrie v Solori SA* (1984) 134 N.L.J. 788; *Clipper Maritime Ltd v Shirlstar Container Transport Ltd (The Anemone)* [1987] 1 Lloyd's Rep. 546.

[14] *Hodgson v James Anderson* (1825) 3 B. & C. 842; *Ardern v Rowney* (1805) 5 Esp. 254. See also *Marginson v Potter & Co* (1976) 11 A.L.R. 64 (Aus).

[15] *Orrell v Coppock* (1856) 2 Jur. N.S. 1244; *Stephens v Squire* (1696) 5 Mod. Rep. 205.

[16] *Masters v Marriot* (1693) 3 Lev. 363.

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

[18] *Ardern v Rowney* (1805) 5 Esp. 254.

[19] *Macrory v Scott* (1850) 5 Ex. 907.

[20] In *Yeoman Credit v Latter* [1961] 1 W.L.R. 828 at 835, after analysing the foundation for the distinction, Holroyd Pearce LJ 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".

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 LJ 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 will fall.[21] 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.[22] 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 W. Fell's, *A Treatise on the Law of Mercantile Guarantees*.[23] 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 Appeal[24] 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

[21] For examples of promises which have been held to be original and not collateral, see the list in Mackay (ed.), *Halsbury's Laws* (2008), Vol.49, para.1059.

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

[23] Fell's *A Treatise on the Law of Mercantile Guarantees*, 2nd edn (1825), pp.27, 28.

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

successfully claimed the return of the deposit from Lloyds on the grounds that its guarantee could not be performed and that the prohibition against payment had every appearance of being permanent. R appealed to the Court of Appeal, which upheld the decision of Langley J on the basis that he was right to regard Lloyds as permanently prohibited by the relevant regulation from paying under the counter-guarantee [2000] Lloyd's Rep. 235. The House of Lords dismissed R's further appeal [2011] UKHL 31. They held that even without the clear words of the recital, the intrinsic nature of the regulation was that in order for it to be effective, the prohibition would have to be permanent. More recently, in *Maud v Libyan Investment Authority* [2015] EWHC 1625 (Ch), Rose J set aside a statutory demand based on the applicant's admitted failure to pay under a guarantee, because such payment was prohibited by Council Regulation EU 240/2011, which implemented the current version of UN sanctions against Libya.

CHAPTER 6

The Liability of the Surety

THE NATURE OF THE SURETY'S LIABILITY

Secondary nature

6-001 A contract of guarantee is an accessory contract, by which the surety undertakes to ensure that the principal performs the principal obligation.[1] It has been described as a contract to indemnify the creditor upon the happening of a contingency, namely the default of the principal to perform the principal obligation.[2] The surety is therefore under a secondary obligation which is dependent upon the default of the principal[3] and which does not arise until that point.[4] In *Ex parte Gardem* (1808) 15 Ves. Jr. 286, it was held that no claim could be brought by the creditor for the price of goods sold and delivered until the period for payment of the price for the goods allowed to the principal had expired. The secondary nature of the surety's liability will preclude the creditor from applying quia timet to compel the surety to set aside a fund to provide for the possibility of the debt becoming due from the principal and the principal making default.[5]

However, the surety's liability is not contingent for the purposes of the distribution rules in insolvency.[6] Further, the surety is no more justified in placing the whole of his property out of the reach of the creditor than is the principal. In *Goodricke v Taylor* (1864) 2 De G. J. & Sm. 135 the surety effected a mortgage of his house to secure an existing debt of £1,100 for which he was liable as surety. He was at the

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1 *Jowitt v Callaghan* [1938] 38 N.S.W. 512; *Moschi v Lep Air Services Ltd* [1973] A.C. 331; *NRG Vision Ltd v Churchfield Leasing Ltd* [1988] B.C.L.C. 624; and see Ch.1, paras 1-004–1-007 for a detailed discussion of the nature of a contract of guarantee. See further the discussion by Sir William Blackburne in *Vossloh AG v Alpha Trains (UK) Limited* [2011] 2 All E.R. (Comm) 307, esp at [21]–[24].

2 *Sampson v Burton* (1820) 4 Moo. C.P. 515. See also *Mallet v Bateman* (1865–66) L.R. 1 C.P. 163, 171; *Fahey v MSD Spiers Ltd* [1973] 2 N.Z.L.R. 655.

3 *Rees v Berrington* (1795) 2 Ves. Jr. 540 at 543 per Lord Loughborough LC; *Lakeman v Mountstephen* (1874–75) L.R. 7 H.L. 17 at 24 per Lord Selborne LC. See generally Ch.1, para.1-005.

4 *Pattison v Guardians of the Belford Union* (1856) 1 H. & N. 523; *Rickaby v Lewis* (1905) 1 T.L.R. 130; and see Ch.7, para.7-002.

5 *Antrobus v Davidson* (1817) 3 Mer. 569; see also *Wolmershausen v Gullick* [1893] 2 Ch. 514 at 524.

6 *Atkinson v Grey* (1853) 1 Sm. & G. 577; *Boyd v Robins and Langlands* (1859) 5 C.B.N.S. 597. See also *MS Fashions Ltd v Bank of Credit and Commerce International SA (In Liquidation)* [1993] Ch. 425.

time also liable on a promissory note for £2,000. He became bankrupt, and the mortgage was held to be void as an assignment to defeat or delay creditors.[7]

The extent of the surety's liability is the same at law and in equity.[8]

The co-extensiveness principle

6-002 The most important aspect of the nature of a guarantor's liability as a secondary liability is that it is co-extensive with the liability of the principal. This means that as a general rule, the surety's liability is no greater and no less than that of the principal, in terms of amount, time for payment and the conditions under which the principal is liable.[9] Accordingly, in *Hartland Public Officer of the Gloucestershire Banking Company v Jukes (Executors and Executrix of William Steward Deceased)* (1863) 1 Hurl. & N. 667, where the principal and surety both gave a promissory note to the creditor as security for advances, no action could be maintained on the note against either principal or surety until an advance was made to the principal by the creditor. Co-extensiveness of liability is one of the essential characteristics of a guarantee that distinguishes it from a contract of indemnity.[10] For example, the guarantee by a surety of the "due fulfilment of any obligation" of a party to a charterparty which contained an arbitration clause covered the principal's liability to pay interest and costs ordered by the arbitrators, as well as the principal amount of the award.[11] The same approach would apply to a temporarily binding adjudication decision. As Ramsey J said in *Beck Interiors Ltd v Russo* [2010] B.L.R. 37 at [50], the principle derived from the cases concerned with arbitration awards is equally applicable to any dispute resolution method which involve a decision on what sum is due or what damages are payable.[12]

Where the liability of a promisor under an agreement exceeds that of the primary debtor, in that, for example, he may be liable when the primary debtor is not, or for an amount for which he is not, then the agreement is not a guarantee, and the promisor undertakes primary liability himself. In such circumstances the contract in question can only be viewed as an indemnity.[13]

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7 See also *Re Ridler* (1882) 22 Ch. D. 74; *Bludoff v Osachoff* [1928] 3 D.L.R. 170. Transactions in fraud of creditors are now dealt with by the Insolvency Act 1986, s.425 (replacing Law of Property Act 1925 s.172).

8 *Samuell v Howarth* (1817) 3 Mer. 272.

9 *Rees v Berrington* (1795) 2 Ves. Jr. 540 at 543 per Lord Loughborough; *Moschi v Lep Air Services Ltd* [1973] A.C. 331; *Hampton v Minns* [2002] 1 W.L.R. 1. See generally Else Mitchell, "Is a Surety's Liability Co-Extensive with that of the Principal?" (1947) 63 L.Q.R. 355; Johan Steyn, "Guarantees: the Co-Extensiveness Principle" (1974) 90 L.Q.R. 246, and see Ch.4, para.4-014; Ch.9, paras 9-019–9-020.

10 See generally Ch.1, paras 1-004–1-005; Ch.4, para.4-014. See also the detailed discussion by Wayne Courtney, *Contractual Indemnities* [2013] at 9.12, 9.17.

11 *Compania Sudamericana de Fletes SA v African Continental Bank Ltd (The Rosarino)* [1973] 1 Lloyd's Rep. 21; *Sabemo Pty Ltd v De Groot* (1991) 8 B.C.L. 132. In the *Compania Sudamericana* case, the guarantee contained an express promise by the surety to pay "up to the amount stated above in accordance with any arbitration award rendered in London (under the terms of the charterparty)". Cf. where the guarantee only extends to the obligations of the principal to perform the underlying contract: *Re Kitchin, Ex p. Young* (1881) L.R. 17 Ch. D. 668 (CA); *Bruns v Colocotronis (The Vasso)* [1979] 2 Lloyd's Rep. 412; *Beck Interiors Ltd v Russo* [2010] B.L.R. 37 per Ramsey J at [46]–[49]. The correctness of the decision in the *Compania Sudamericana* case, to the extent that it depends on language other than the surety's express promise to honour the arbitration award, has been recently doubted by the Singapore Court of Appeal, as it appears to be inconsistent with *Re Kitchin* (a case which was apparently not cited to Mocatta J): *PT Jaya Sumpiles Indonesia v Kristle Trading Ltd* [2009] 3 S.L.R. 689.

12 See also *Sabah Shipyard (Pakistan) Ltd v Pakistan* [2008] 1 Lloyd's Rep. 210, esp at [134]–[149], Christopher Clarke J. But clear words are needed. As he said at [146], "[a] guarantee that merely guarantees the principal debtor's obligations, or his performance, or the amount or balance due from the principal debtor is not sufficient to require the surety to honour an arbitration award".

As Sir William Blackburne put it in *Vossloh AG v Alpha Trains (UK) Limited* [2011] 2 All E.R. (Comm) 307 at [24]:

> "An essential distinguishing feature of a true contract of guarantee—but not its only one—is that the liability of the surety (i.e. the guarantor) is always ancillary, or secondary, to that of the principal, who remains primarily liable to the creditor. There is no liability on the guarantor unless and until the principal has failed to perform his obligation. The guarantor is generally only liable to the same extent that the principal is liable to the creditor."[14]

However, the principle of co-extensiveness is not an immutable rule. The precise extent of the liability of the surety will always be governed by the provisions of the guarantee on their true construction,[15] and the parties remain free in certain respects to provide for limitations of the surety's liability without detracting from the nature of the contract as a guarantee.[16] Furthermore, the court has not always regarded itself as bound to treat the surety as co-extensively liable with the principal, and there are circumstances where the surety will remain liable notwithstanding the fact that the principal is not, or is no longer, liable for the principal obligation.[17]

One question which often arises is whether the surety's liability sounds in debt or in damages. In *Moschi v Lep Air Services Ltd* [1973] A.C. 331, the House of Lords appeared to express a general rule that the surety's liability sounded in damages and not in debt, even where he was guaranteeing a debt.[18] Lord Diplock's penetrating historical analysis of the nature of the secondary liability of a surety revealed that the remedy for the failure by the surety to perform his own obligation to see to it that the principal performed his own obligations, even to pay a sum of money, lay not in indebitatus assumpsit (debt) but special assumpsit (damages).[19] As Lord Diplock said:

> "The legal consequence of this is that whenever the debtor has failed voluntarily to perform an obligation which is the subject of the guarantee, the creditor can recover from the guarantor as damages for his breach of contract of guarantee whatever sum the creditor could have recovered from the debtor himself as a consequence of that failure. The debtor's liability to the creditor is also the measure of the guarantor's."

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13 See *Moschi v Lep Air Services Ltd* [1973] A.C. 331; *Board of Trade v Employers' Liability Assurance Corp* [1910] 2 K.B. 649; *Pattison v Guardians of the Belford Union* (1856) 1 H. & N. 523; *Oastler v Pound* (1863) 11 W.R. 518.

14 Sir William Blackburne went on, at [25], to explain the distinction between contracts of guarantee and contracts of indemnity and explained (at [26]) how the co-extensiveness principle does not apply to a contract of indemnity.

15 As to which see generally Ch.4, esp. paras 4-002–4-003.

16 See, e.g. *Fahey v MSD Spiers Ltd* [1973] 2 N.Z.L.R. 655; [1975] 1 N.Z.L.R. 240 PC, where the surety only guaranteed payment for future purchases, and not past indebtedness. See further Ch.4, paras 4-016–4-017.

17 *Moschi v Lep Air Services Ltd* [1973] A.C. 331; *Hyundai Shipbuilding & Heavy Industries Co v Pournaras* [1978] 2 Lloyd's Rep. 502; *Hyundai Heavy Industries Co Ltd v Papadopoulos* [1980] 1 W.L.R. 1129; *Stocznia Gdanska SA v Latvian Shipping Co* [1998] 1 Lloyd's Rep. 609; *Hampton v Minns* [2002] 1 W.L.R. 1; and see Johan Steyn, "Guarantees: The Co-Extensiveness Principle" (1974) 90 L.Q.R., 246. See *Vossloh AG v Alpha Trains (UK) Limited* [2011] 2 All E.R. 307 at [23]–[26] for a comprehensive summary of the law on the point.

18 See Lord Simon of Glaisdale at 352. The general rule seems to have been assumed.

19 See 347–349.

However, it is clear that this is not an immutable rule of law, but depends (as the House of Lords was careful to say) on the construction of the words of the guarantee.[20] Thus Lord Reid explained that there are at least two possible forms of agreement; a person might undertake no more than that if the principal debtor fails to pay any instalment, he will pay it. There would then on the debtor's failure arise an obligation to pay, but if for any reason the debtor ceased to have an obligation to pay on the due date, he cannot have failed to perform that obligation and the condition attached to the undertaking by the surety to pay would not be fulfilled. Thus the subsidiary obligation would never arise. On the other hand, the guarantor's obligation might be of a different kind; he might undertake that the principal debtor will carry out his contract. If at any time and for any reason the principal debtor acts or fails to act as required by his contract, he not only breaks his own contract but puts the guarantor in breach of his contract of guarantee. Then the creditor can sue the guarantor, not for the unpaid instalment but for damages.[21] Lord Reid made it clear in his analysis that the surety's obligations under both species of guarantee are secondary, in that they depend upon a default by the principal in performance of his contractual obligations. However, in the former case the promise by the surety is to "pay the sum if the principal does not" whereas in the latter case it is to "see to it that the debt is paid". It follows from this that if what is guaranteed is the performance by the principal of his obligations, even payment obligations, then the surety's liability lies in damages. If, on the other hand, the surety's promise is that, on the happening of certain events, he will pay a sum of money, then he is liable to make that payment once those events have happened and the creditor will have an action against him in debt.[22] In *Moschi v Lep Air Service Ltd* the agreement in question was undoubtedly a "see to it" guarantee, and Lord Diplock's and Lord Simon's observations were directed at a contract of that nature, rather than a contract falling into the first of the categories mentioned by Lord Reid.

The distinction between a guarantee of the principal's performance and the promise to pay a sum of money if the principal does not is a fine one and will depend on the precise words of the guarantee. In *Hampton v Minns* [2002] 1 W.L.R. 1, Kevin Garnett QC (sitting as a Deputy High Court Judge), after careful analysis of *Moschi v Lep Air Services Ltd*, held that the fact that the sureties had promised to "pay or discharge to" the creditor bank all monies due and owing by the principal created a debt obligation on their part, and not an obligation to pay damages.[23]

Ascertaining into which of the categories of guarantee a particular contract of

[20] The observation of Peter Smith J in *Securum Finance v Ashton* [2002] All E.R. (D) 380 at [58] that it is a "fundamental principle that a surety liability is a secondary liability to pay damages measured by the failure of the principal debtor to pay" is not correct so far as the reference to damages is concerned. See further para.6-030 and Ch.7, para.7-018, and now the analysis by the Court of Appeal in *McGuinness v Norwich and Peterborough Building Society* [2012] 2 All E.R. (Comm) 265.

[21] *Moschi v Lep Air Services Ltd* [1973] A.C. 331 at 344–345.

[22] See *Remblance v Octagon Assets Ltd* [2010] 2 All E.R. 688 per Dyson LJ at [41] for a recent restatement of the principle in the context of the exercise of the discretion to set aside a statutory demand against a surety under IR r.6.5(4)(d). See also *White v Davenham Trust Ltd* [2011] EWCA Civ 747 per Lloyd LJ at [40], distinguishing *Remblance* when applying IR r.6.5(4)(c).

[23] See [99] of his judgment. One question may be whether the instrument creates two obligations (an obligation of guarantee plus a separate obligation to pay losses on demand) or one obligation (a guarantee, with a procedural provision for demand). The answer depends on the precise language of the instrument, but is usually likely to be read as creating only one obligation: see *Romain and Wolfson v Scuba TV* [1997] Q.B. 887 per Evans LJ at 895. However, in *Vossloh AG v Alpha Trains (UK) Limited* [2011] 2 All E.R. 307, Sir William Blackburne said (at [45]) that a clause in a standard form guarantee may well contain sub-clauses which are a mixture of primary and secondary obligations, with a view to ensuring that the surety is obliged to answer for every kind of default that could possibly arise under the underlying contract.

suretyship falls has assumed a critical importance in the context of insolvency. One of the primary reasons why a creditor will wish to take a guarantee as security is that he can look to the surety for payment instead of pursuing the principal, which is a particular advantage when the principal is in financial difficulty. It is the surety, rather than the creditor, who bears the risk of the principal's insolvency. One might expect, therefore, that in circumstances where the creditor could issue a statutory demand against the principal for a debt which is the subject of the underlying obligation, he should be able to do the same in respect of the guarantor (assuming that the guarantor has no independent defence on reasonable grounds). In principle, his ability to issue a statutory demand in those circumstances should not turn on whether, as a matter of construction, the guarantee is a "see to it" guarantee or "pay it myself" guarantee; in either case the amount owed by the principal and the amount for which the surety liable is the same ascertained sum.[24] However, following the decision of the Court of Appeal in *McGuinness v Norwich and Peterborough Building Society* [2012] 2 All E.R. (Comm) 265, it may well matter. The problem arises because it has been held at first instance that a bankruptcy petition cannot be founded on a claim for damages, even if liquidated and known: see *Hope v Premierpace (Europe) Ltd* [1999] B.P.I.R. 695 and *Navier v Leicester* [2002] EWHC 2596 (both Rimer J, as he then was).[25]

In *McGuinness v Norwich and Peterborough Building Society* the court was presented with the problem of a bankruptcy petition based on a default under a guarantee. The Building Society had taken a guarantee on its standard form from the appellant, Spencer, for the debts of his brother Craig. The guarantee contained the following clauses:

> "2.2 You guarantee that all money and liabilities owing, or becoming owing to us in the future, by the Borrower (whether actual or contingent, whether incurred alone or jointly with another and whether as principal or surety) will be paid and satisfied when due.
>
> 2.3 Any amount claimed under the Guarantee is payable by you immediately on demand by us.
>
> …
>
> 2.4 As a separate obligation you agree to make good (in full) any losses or expenses that we may incur if the Borrower fails to pay any money owed to us, or fails to satisfy any other liabilities to us, or if we are unable to enforce any of the Borrower's obligations to us or they are not legally binding on the Borrower (whatever the reason) …
>
> 4.2 Your obligation under this Guarantee are those of principal, not just as surety. We will not be obliged to make any demand on, or take any steps against, the Borrower or any other person before enforcing this Guarantee."

Craig defaulted and the Building Society demanded £1.2 million odd from Spencer. He did not pay it, and so the Building Society presented a bankruptcy petition. Counsel for Spencer submitted that a creditor having the benefit of a "see to it"

[24] In *McGuinness v Norwich and Peterborough Building Society* [2011] 1 W.L.R. 613, Briggs J at [26] took the same view. He said "in a case like the present, where there is a debt rather than damages owed by the principal debtor and where, on any view, the guarantor's obligation is to pay a sum identical to that debt, it seems to me to risk an absurd waste of costs and delay to require the creditor first to issue a claim and obtain an inevitable summary judgment upon it before beginning bankruptcy proceedings." However, in the Court of Appeal [2012] 2 All E.R. (Comm) 265, Patten LJ (at [19]) said that "experience teaches one in this field as in many other areas of law that views about what might constitute a rational system of law often have to give way to an established practice which cannot be altered except by legislation". He was referring in that case to the practice of the bankruptcy courts.

[25] Such claims are outside ss.267(2) and 382(3) of the Insolvency Act 1986. Briggs J expressed some disquiet about *Hope v Premierpace* in *McGuinness v Norwich Peterborough Building Society* [2011] 1 W.L.R. 613 at [24]–[26], but the Court of Appeal [2012] 2 All E.R. (Comm) 265 was prepared to hold that it was correctly decided on its own facts (see Patten LJ at [40]–[41]), and see below.

guarantee can never present a bankruptcy petition based upon the guarantor's liability without first obtaining a judgment for payment of a specific sum, because, as the House of Lords made clear in *Moschi v Lep Air Services Ltd*, the guarantor's obligation lies in damages only—even where it is obvious that the measure of the guarantor's liability is identical to the amount of the principal debtor's own debt. As Rimer J said in *Hope v Premierpace*, it is irrelevant (to establish standing to present a petition under s.267(2)(b)) that the creditor is able to identify his claim down to the last penny.

In *McGuinness*, the Court of Appeal analysed the question whether liability under a guarantee was a debt for a liquidated sum within the meaning of s.267(2)(b) of the Insolvency Act 1986. The case is of importance for its examination of two principal issues: first, the nature of liability under a guarantee and whether it sounds in debt or damages, and secondly whether a claim for liquidated damages by way of enforcement of a guarantee is a debt capable of founding a bankruptcy petition under s.267(2)(b) of the Insolvency Act 1986.

As to the first issue, Patten LJ said (at [7]) that a guarantee of a loan may impose one or more of the following types of liability on the guarantor: (1) a "see to it" obligation, namely an undertaking by the guarantor that the principal will perform his own loan obligations to the creditor; (2) a conditional payment obligation, namely a promise by the guarantor to pay the loan principal and interest which falls due if the principal does not pay; (3) an indemnity; and (4) a concurrent liability with the principal for what is due under the contract of loan. The obligations of types (2) and (4) arise in debt. As to indemnity, it is clearly established that an indemnity is enforceable by way of action for unliquidated damages, on the basis that the indemnifier has broken his promise to prevent the indemnitee from suffering the type of loss specified in the contract.[26] A "see to it" obligation also sounds in damages, following *Moschi v Lep Air Services*.

As to the second issue, Patten LJ held, after a penetrating analysis of the 19th century cases, that liability under a "see to it" obligation under a guarantee did not fall within s.267(2)(b) of the Insolvency Act 1986 and so could not be the basis of a bankruptcy petition. He said (at [36]) that a debt for a liquidated sum under the section must be a pre-ascertained liability under the agreement which gives rise to it. So where the guarantee on its proper construction contained a promise by the guarantor to pay a sum if the principal did not, then his liability sounds in debt and is necessarily a pre-agreed amount. Where, however, the guarantee contains a "see to it" obligation, then "as a matter of general principle and ordinary language" the liability would not constitute a debt for a liquidated sum within the section and could not found a petition (at [42]–[43]). Patten LJ said that Rimer J had been correct in *Hope v Premierpace* on its facts, and had not gone so far as to say that a claim in damages could not be a debt within s.267(2)(b) regardless of the nature of the claim. The key question is whether the damages can be calculated from the contractual terms giving rise to the guarantor's liability; and if they can then they are "a debt … for a liquidated sum" for the purposes of the section[27] (see also Patten LJ at [51]).

The case is also significant, and (it is respectfully suggested) less satisfactory, for its approach to the construction of the particular terms of the guarantee. The Court

[26] See *Firma C-Trade SA v Newcastle Protection and Indemnity Association* [1991] 2 A.C. 1 at 33–36.

[27] Patten LJ then went on to examine a further series of cases prior to the Bankruptcy Act 1869 to see if there was a bankruptcy practice under which see to it liabilities under guarantees were treated as debts, and concluded that there was not ([43]–[51]).

of Appeal held that on its proper construction the language of liability under cl.2.2 was ambiguous but, on balance, created a conditional payment liability and not a "see to it" liability sounding in damages (in contrast to cl.2.4, which did). Patten LJ sought to support that conclusion by reference to cl.2.3 which made the amount payable on demand. It is not easy to see why the addition of a demand requirement should necessarily make the obligation one of debt as opposed to sounding in damages, not least since, as Patten LJ pointed out, a request for payment of a presently due debt is unnecessary, and the fact that a demand is (as Patten LJ also noted) always anyway a requirement where the guarantee is in the nature of a collateral promise to pay if the principal does not simply shows that the liability is an ancillary or secondary liability as opposed to a concurrent liability.[28] This approach, of characterising the guarantor's obligation as lying in debt as opposed to damages by reference to whether his obligation arose only on the making of a valid demand echoed Briggs J's approach at first instance, namely that if the guarantee created liability only on demand then it could not be a "see to it" obligation but had to sound in debt. These decisions turn on the particular words of the instrument and care should be taken in seeking to extract any point of principle. However, if this analysis were correct, the combined effect of *Hampton v Minns* and *McGuinness v Norwich and Peterborough Building Society* (both at first instance and in the Court of Appeal) would be that failure to pay under an on-demand guarantee never sounds in damages but always in debt, since demand is a pre-condition to liability. With respect, that conclusion would erode the statements of general application in Lord Diplock's speech in *Moschi*, and would undermine the importance of the historical origins of the liability under accessory contracts which underpins his whole approach. It is respectfully suggested that this aspect of *McGuinness* is misconceived. The fact that the guarantor undertakes to pay "on demand" does not undermine the principle of co-extensiveness or reduce its scope, still less does it change the nature of the promise made under what is otherwise a "see to it" guarantee. Although the surety cannot be sued until a demand is made on him, when that demand is made, his liability will cover all sums falling due from the moment of the principal's default, and not from the moment of the demand. The requirement of a demand is a purely procedural requirement, and can be waived by the surety: *Stimpson v Smith* [1999] Ch. 340, and see generally Ch.7, para.7-005. Thus the demand requirement cannot, in and of itself, affect the fundamental nature of the surety's obligation. The approach adopted by Briggs J and the Court of Appeal in *McGuinness* finds no trace of support in *Moschi* itself.

There is one further aspect of *McGuinness* that calls for attention. The guarantee in that case contained both a demand requirement and a principal debtor clause. Briggs J sought to contrast the language of cl.2.2 with that of the guarantee in *Moschi v Lep Air Services Ltd*, because it did not state in terms that the guarantor's obligation was to "see to it" that the principal debtor himself pays all amounts due, rather, he said, it was neutral on the question by whom the guarantor promises that those debts will be paid.[29] That view is questionable, since cl.2.2 was couched expressly in terms of a "guarantee" by the surety that the moneys and liabilities *owing by the Borrower* would be paid and satisfied when due. On the face of it, that

[28] See *Bradford Old Bank Ltd v Sutcliffe* [1918] 2 K.B. 833; *Rowe v Young* [1820] 2 Bli. 391 at 465 per Bayley J, quoted by Patten LJ at [61].

[29] The guarantee in *Moschi* stated that "in consideration of the above Mr Moschi has personally guaranteed the performance by [the principal] of its obligation to make the payments at the rate of £6,000 per week together with the final payment of £4,000 as hereinbefore set out", see [1973] A.C. 331 at 343.

is an obligation falling within the second of Lord Reid's two categories, premised upon the borrower having the primary liability to pay, and therefore a "see to it" obligation. However, Briggs J's interpretation of cl.2.2 was not a central part of his reasoning, because he considered that it was enough that the guarantee includes, rather than necessarily consists of, a debt obligation, which this one, he held, did. That was because of the principal debtor provision (cl.4.2), which he construed as a promise by Spencer to make his brother's debts his own "as in *MS Fashions v BCCI*".[30] Again with respect, that takes the object and purpose of the standard principal debtor clause too far. Its purpose is not to make the surety a principal debtor so that his liability is joint and several with the principal debtor and not truly accessory. Its purpose, as explained by Dillon LJ in *MS Fashions v BCCI* [1993] Ch. 425, (in a passage both cited and applied by Briggs J) was simply to dispense with the need for a demand on the surety.[31] Without clear words, the principal debtor clause should not be treated as turning the contract into one of primary liability: if it did that, it would not be a guarantee and the debt/damages issue would not arise. On this point, the Court of Appeal founded itself on cll.2.2 and 2.4 and not on cl.4.2, but nonetheless went on to express the (obiter) view that the second sentence of cl.4.2 reflected the status of the guarantor as a principal debtor by making it clear that his liability was concurrent with that of the principal debtor and not contingent on it, since the creditor was not obliged to go first against the principal debtor. This is also highly questionable. The fact that the terms of a guarantee excuse the creditor from having to make demand on the principal debtor for the accrued debt, or otherwise pursue him before being able to claim from the guarantor (which is a very standard provision)) does not convert the guarantor's accessory obligations, to answer for the principal debtor's liabilities, into primary and concurrent obligations. If that were so, it would have very wide-ranging ramifications, including the non-availability of the protection of the Statute of Frauds and the disapplication of the rule in *Holme v Brunskill*.[32] Indeed, the instrument would arguably no longer be a guarantee at all.[33]

Were the matter free from authority, there might be a great deal to be said for determining that the nature of the cause of action against the surety depends on the nature of the performance required of the principal rather than the nature of the obligation undertaken by the surety: thus if the principal's liability sounds in debt, so does the surety's.[34] That simple approach to the matter would at least accord with

[30] In *Sofaer v Anglo Irish Finance Plc* [2011] EWHC 1480 (Ch) at [12], Lewison J regarded *McGuinness* as a case in which Briggs J was considering the distinction between contracts of guarantee and contracts of indemnity. He said that a contract of indemnity under which the so-called guarantor undertakes obligations as a principal debtor will normally give rise to a debt, and on the construction of the contract in that case, he decided that it contained separate indemnity obligations. The same approach was taken by Burton J in *Nakanishi Marine Co Ltd v Gora Shipping Ltd* [2012] EWHC 3383 at [40]. These cases must be read in the light of the Court of Appeal's decision in *McGuinness*.

[31] See also *TS&S Global Ltd v Fithian-Franks* [2007] EWHC 1401; [2008] 1 B.C.L.C. 277, David Richards J. The other function that a "principal debtor" clause commonly serves is to preserve the liability of the guarantor in circumstances in which he might otherwise be discharged, see *Heald v O' Connor* [1971] 1 W.L.R. 497 and the discussion in para.6-028 and Ch.9 at paras 9-010 and 9-029–9-034 below.

[32] As to which see Ch.9 below.

[33] As Sir Bernard Rix pointed out in *CIMC Raffles Offshore (Singapore) Ltd v Schahin Holding SA* [2013] EWCA 644 at [30], a principal debtor clause does not generally turn a guarantee into an indemnity.

[34] See the view expressed in O'Donovan and Phillips, *The Modern Contract of Guarantee* (2010), para.10-191, based on the Australian authorities cited there, to the effect that the action lies in debt if the underlying obligation is to pay a debt or other liquidated sum, because the promise by the surety is to pay all sums "due" "owing" or payable" by the debtor. However those authorities declined to follow Lord Diplock's analysis in *Lep Air v Moschi* and therefore are likely to be of limited assistance in England and Wales.

an obligation of co-extensiveness, but until reconsideration by the Supreme Court that answer to the problem is not open. An alternative argument that has been put forward by some commentators is that if the principal's failure consists of failure to pay an accrued debt, the surety's obligation also sounds in debt and not damages, whereas if his default is in relation to unaccrued obligations which have not yet fallen due, then his liability lies in damages and so does that of the surety.[35] The difficulty with that argument is that it finds no trace of support in *Moschi* itself and it still diverges from the historical analysis that underpins Lord Diplock's speech in that case. Even if that argument were accepted, it would not be a complete answer to the difficulty that arose in the *McGuinness* case. Moreover, it would create a distinction between past and future debts that would be difficult to justify commercially.

It may be that the most satisfactory solution to the problem highlighted by *McGuinness v Norwich and Peterborough Building Society* (at least in the context of bankruptcy petitions, when it commonly arises) would be for the Supreme Court to reconsider the proper approach to s.267(2) of the Insolvency Act and to overrule Rimer J's decisions in *Hope v Premierpace (Europe) Ltd* [1999] B.P.I.R. 695 and *Navier v Leicester* [2002] EWHC 2596 and the Court of Appeal's rather guarded approval of those decisions. As Briggs J observed in *McGuinness* at [25], the underlying purpose of that section appears to be to distinguish between cases where there is no issue as to the amount of a liability and cases where some process of assessment by a court is necessary before the amount can be identified. If that is indeed the policy behind the statute, then in principle the question whether a creditor can proceed by way of statutory demand against a surety ought not to depend on the construction of the contract of suretyship, or on whether his cause of action lies in debt or damages.

EXTENT OF THE SURETY'S LIABILITY: THE PROVISIONS OF THE CONTRACT OF GUARANTEE

Limitations upon liability

Prospective and retrospective liability

6-003 The liability of the surety may be restricted to obligations of the principal which have already arisen prior to the contract of guarantee, or which are incurred after the contract of guarantee is made, or he may be liable both prospectively and retrospectively. As has been mentioned earlier in this work,[36] most modern guarantees will clearly indicate that the guarantee applies to obligations already incurred by the principal towards the creditor as well as those which may fall due in the future. The difficulties which may arise in construing a contract as being prospective, retrospective, or both, are considered in detail in Ch.4.

[35] See *Goode on Legal Problems of Credit and Security*, edited by L. Gullifer, 5th edn (London: Sweet & Maxwell, 2013), para.8-10. See also *Hyundai Heavy Industries Co Ltd v Papadopoulos* [1980] 1 W.L.R. 1129, where Lord Fraser said that the principal's obligation fell into both categories of obligation identified by Lord Reid in *Moschi*.

[36] See Ch.4, para.4-016.

The question whether a guarantee is retrospective or prospective arises most crucially in the context of payments made by the principal in satisfaction of his indebtedness to the creditor, and whether these are in extinction or reduction of the guaranteed indebtedness. The rule in *Clayton's* case,[37] which will operate in the absence of any express appropriation of a particular payment by the principal or the creditor to any particular indebtedness, will mean that the earliest payment is appropriated to the earliest indebtedness. The consequence of this is that in the case of a retrospective guarantee, the payments by the principal which reduce or extinguish his indebtedness will pro tanto reduce or extinguish the surety's liability. Where, however, the guarantee is prospective in effect, the earliest payment by the principal will reduce his own liability incurred prior to the execution of the guarantee, but not affect the liability of the surety, who will remain liable in full for the post-guarantee indebtedness.[38] The effect of *Clayton's* case can be avoided by a specific appropriation of a payment by the principal (or by the creditor in his turn).[39]

Continuing or specific liability

6-004 A guarantee may relate to one or more specific transactions,[40] or may relate to a series of indefinite transactions.[41] The distinction between these two forms of guarantee can be very important, and is often extremely difficult to draw.[42]

The distinction between a specific and a continuing guarantee is most crucially at issue when the principal makes a payment to the creditor. For example, if the principal borrows £1,000 under an overdraft facility, and the guarantee is for a specific sum of £1,000, the operation of the rule in *Clayton's* case[43] will mean that a payment by the principal of, say, £500 will reduce the surety's liability pro tanto, and if the principal then pays another £500 the surety's liability will be extinguished altogether, even though the principal has borrowed further sums from the creditor in the meantime and is liable for £1,000 newly advanced.[44] However, where the guarantee is a continuing one, the surety will remain liable in full for the principal liability as it arises from time to time, and the payments in will not affect his liability.

Most modern standard form guarantees contain an "all moneys" clause, which provides that the guarantee will cover "all moneys which are now or which may from time to time be owing or remain unpaid", and provide that the guarantee be a "continuing security"; thus the rule in *Clayton's* case only rarely operates in favour of the surety. However, in the Irish Supreme Court decision of *The Governor and Company of the Bank of Ireland v McCabe* unreported, September 19, 1994, the bank had taken guarantees from directors of the principal, which was a customer

[37] *Devaynes v Noble, Clayton's* case (1816) 1 Mer. 572.
[38] See the discussion in Ch.4, para.4-016.
[39] For a full discussion of rights of appropriation and the rule in *Clayton's* case, see Ch.9, paras 9-005–9-008.
[40] See, e.g. *Kay v Groves* (1829) 6 Bing. 276; *Walker v Hardman* (1837) 4 Cl. & Fin. 258; *Re Medewe's Trusts* (1859) 26 Beav. 588; *J Wiseman & Sons Ltd (In Liquidation) v Harris* [1932] N.Z.L.R. 663; *Phillips Petroleum v Quintin* (1998) L.T.L. March 13, 1998, PC
[41] See, e.g. *Wood v Priestner* (1866) L.R. 2 Ex. 66; *Heffield v Meadows* (1869) L.R. 4 C.P. 595; *Parr's Banking Co v Yates* [1898] 2 Q.B. 460 (illustrating the effect of limitation on interest on a guaranteed account).
[42] See the discussion in Ch.4 at para.4-017.
[43] See para.4-016, and Ch.9, para.9-007.
[44] See *Heffield v Meadows* (1869) L.R. 4 C.P. 595.

of some years' standing. The guarantees were expressed to be "a continuing security on the guarantors". The bank also held certain stock owed by the principal as security for the guaranteed loan. The bank was asked to release part of that stock so that the principal could sell it, to which it duly agreed. The sale went ahead and the loan was repaid. The bank then loaned the principal further moneys on the security of "any security held however". The bank subsequently claimed repayment under the guarantees. Egan J held that the bank's claim failed, since the guarantees covered only the original indebtedness which had been discharged, and did not extend to the new advance. The case illustrates the fallibility of the "continuing security" provision in standard form guarantees. Banks would be well advised to spell out in their facility letter exactly what security they are seeking and, if they wish to cover future advances, to include an "all moneys" or similar provision in the guarantee itself.[45]

In *Banner Lane Realisations Ltd (In Liquidation) v Berisford Plc* [1997] 1 B.C.L.C. 380, the Court of Appeal considered the meaning of the phrase "future indebtedness" in a guarantee contained in a debenture. They rejected the argument advanced by the surety that liability to indemnify the creditor was not a debt and therefore not indebtedness within the meaning of the debenture. They held that "future indebtedness" included not only a present obligation to pay a sum certain in the future, but also an (unquantified) sum in the future or on a contingency.[46] That included an obligation arising in the future.

The modern approach to "all moneys" provisions

6-005 There is increasing judicial support in Australia for a more restrictive approach to "all moneys" guarantees. In *Estoril Investments Pty Ltd v Westpac Banking Corporation* (1993) 6 B.P.R. 13, 146, Young J laid down guidelines for construction of "all moneys" mortgages, most importantly that only debts of the same type or character as the original debt are secured by the mortgage, and that once the original debt has been fully discharged the mortgage is extinguished and cannot secure further loans.[47]

The protection of sureties from the harshness and abuse of all moneys clauses is gaining ground in England. *Lloyds Bank Plc v Hawkins* [1998] Lloyd's Rep. Bank. 379 illustrates a significant pitfall for banks when claiming moneys due under an "all moneys" charge.

In March 1982 H charged his house by way of legal mortgage to Lloyds Bank. The mortgage was an "all moneys" security with H covenanting to "pay to the Bank on demand all money and liabilities whether certain or contingent which now are or at any time hereafter may be due owing or incurred by the Mortgagor to the Bank".

In January 1987 H entered into a guarantee with the bank of the borrowings of his company, G. The guarantee was expressed to be in addition to any other security held by the bank. In 1997 the bank issued proceedings against H, seeking possession of his house and a money judgment under the mortgage. These proceedings related to money owed on his overdraft account and a separate loan account as well

[45] See Mackay (ed.), *Halsbury's Laws of England* (2008), Vol.49, paras 1108–1110.
[46] For a comprehensive discussion of the surety's liability for sums owing contingently to the creditor, see *National Bank of Australasia v Mason* (1976) 50 A.L.J.R. 362, and the discussion of that case in O'Donovan and Phillips, *The Modern Contract of Guarantee* (1996), at pp.247–250, and O'Donovan and Phillips, *The Modern Contract of Guarantee* (2010), paras 5-107–5-111.
[47] See also *Burke v State Bank of New South Wales Ltd* [1994] 37 N.S.W.L.R. 53, esp. at 72–73.

CHAPTER 12

Rights of the Surety Against Co-Sureties

NATURE AND ORIGIN OF RIGHTS

12-001 Where two or more persons guarantee the same debt, whether jointly, severally or jointly and severally, they are co-sureties. In general, the law of restitution permits co-obligees such as co-contractors, co-insurers and co-trustees to recover contributions from each other should one of them be required by the creditor to pay more than their due share of a common obligation for which they are all liable.[1]

It is doubtful whether there was any common law action for contribution prior to the beginning of the nineteenth century, on the basis that to admit such a claim would be a "great cause of suits".[2] The courts of equity, however, had developed the principle in the early seventeenth century that, "who can pay must not only contribute their own shares but they must also make good the shares of those who are unable to furnish their own contribution".[3] At common law, therefore, the insolvency of one of the co-sureties did not proportionately increase the liability of the solvent sureties to contribute,[4] whereas in equity the solvent sureties had to make good the contributions of their insolvent co-sureties.[5] Since the Judicature Act 1873 the equitable rules have prevailed.

The surety's right of contribution is based upon the equitable principle that the creditor should not be permitted to bring down the burden of the whole debt upon one surety only,[6] and recognises that the co-sureties have a common interest and a common burden.[7] It is a right that arises independently of contract, from the essence of the relationship of co-surety itself, and the notion that the burdens and the benefits of that position should be shared.[8] Where a surety pays more than his rateable proportion of the debt, he is entitled to exercise this right against his co-

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1 See Goff and Jones, *The Law of Restitution* (2007), paras 13-01, 14-01 and following; now *The Law of Unjust Enrichment* (2011), paras 19-01, 20-01 and following.

2 *Wormleighton v Hunter* (1613) Godb. 243.

3 *Lowe & Sons v Dixon & Sons* (1885) 16 Q.B.D. 455 at 458 per Lopes J; *Peter v Rich* (1630) 1 Rep. Ch. 34; *Morgan v Seymour* (1638) 1 Rep. Ch. 120.

4 *Batard v Hawes* (1853) 2 El. & Bl. 287; *W. R. Browne v Lee* (1827) 6 B. & C. 689.

5 *Hole v Harrison* (1675) 1 Ch. Cas. 246; *Dallas v Wells* (1879) 29 L.T. 599; *Lowe v Dixon* (1885) 16 Q.B.D. 455 per Lopes J.

6 *Dering v Earl of Winchelsea* (1787) 1 Cox Eq. Cas. 318; *Craythorne v Swinburne* (1807) 16 Ves. Jr. 160; *Wolmershausen v Gullick* [1893] 2 Ch. 514; and see the discussion of these cases in Ch.11, para.11-002.

7 *Dering v Earl of Winchelsea* (1787) 2 Bos. & P. 270; *Ellesmere Brewery Co v Cooper* [1896] 1 Q.B. 75 at 79 per Lord Russell CJ; *Albion Insurance Co Ltd v Government Insurance Office of New South Wales* (1969) 121 C.L.R. 342; *Eagle Star Ltd v Provincial Insurance Plc* [1993] 3 W.L.R. 257.

8 *Dering v Earl of Winchelsea* (1787) 1 Cox Eq. Cas. 318; *Stirling v Forrester* (1821) 3 Bli. 575; *Ramskill v Edwards* (1885) 31 Ch. D. 100; *American Surety Co of New York v Wrightson* (1910) 103 L.T. 663 at 667; *Shepheard v Bray* [1906] 2 Ch. 235; *Eagle Star Ltd v Provincial Insurance Plc* [1993] 3 W.L.R. 257.

surety, because he has discharged their obligations to the creditor.[9] It exists only where the two sureties guarantee the same debt. In *Dering v Earl of Winchelsea* (1787) 1 Cox Eq. Cas. 318, Eyre CB said:

> "In the particular case of sureties, it is admitted that one surety may compel another to contribute to the debt for which they are jointly bound. On what principle? Can it be because they are jointly bound? What if they are jointly and severally bound? What if severally bound by the same or different instruments? In every one of those cases sureties have a common interest and a common burden. They are bound as effectually quoad contribution, as if bound in one instrument, with this difference only that the sums in each instrument ascertain the proportions, whereas if they were joined in the same engagement they must all contribute equally."[10]

12-002 It follows, therefore, that it is immaterial that the sureties are jointly, severally or jointly and severally liable, that they are bound by different instruments,[11] or at different times,[12] or that they know nothing of each others' existence as such,[13] or that the first surety agreed to be bound before the co-surety was approached.[14] In *Capital Cashflow Finance v Southall* [2004] EWCA Civ 817, the Court of Appeal decided that there is no relief in equity wider than that provided by the common law, and that the question whether a surety's liability is conditional upon the signature of an intended co-surety on a joint and several guarantee is simply a question of construction. There is no wider discretion in equity based on expectation, not amounting to a term or condition. The Court of Appeal went on to say that there is a relevant distinction between the situation where a single document is intended to be signed by different persons undertaking liability as surety, and the situation where different documents are prepared (as in the case before them), and it is not enough to relieve surety A from liability under his guarantee where the signature of surety B on a separate guarantee was intended as part of a larger transaction but is never obtained.[15] Mance LJ said at [17]:

> "Where a single document is prepared for signature by several persons, the document on its face points to a conclusion that the signatures of all are essential to its validity. Where separate documents are prepared, each for separate signature by a separate individual, the contrary applies. Of course there are cases where an individual document is, according to its express terms or implicitly when construed in the light of its express terms and all the surrounding circumstances, conditional upon the signature of another document: see eg *Greer v Kettle*.[16] But it is not by itself sufficient that the documents are all part of a larger transaction … Further, even if the signature of all such documents by their intended signatories is regarded as important by the parties seeking the same, it cannot be assumed without more that each intended signatory also regards the other's signature as critical, let alone that he regards it as critical that the other is signing an identical document."

In *Harvey v Dunbar Assets Plc* [2013] EWCA Civ 952; [2013] B.P.I.R. 7202, the respondent bank issued a statutory demand against the appellant based on a guarantee under which he and three other individuals had guaranteed the liabilities of a property development company. He contended that he was not liable under the guarantee because one of his co-sureties alleged that his signature had been forged. The judge found him liable because cl.4(a)(iv) of the guarantee provided that neither his obligations nor the bank's rights would be "discharged, impaired or otherwise affected by … any failure to take or fully to take any security contemplated by or otherwise agreed to be taken by taken in respect of the Principal Debtor's obligations". The judge read the definition of Guarantor (which said "every person liable under this Deed") as meaning "every person potentially liable under this Deed") and held that the failure by the bank to take security from one of the signatories did not discharge, impair or affect the obligations of the others. The Court of Appeal reversed the judge. Gloster LJ, giving the only reasoned judgment, held that where a signatory to a guarantee had assumed liability under it in circumstances where other contemplated security had not been obtained was a question of construction against its admissible factual matrix. If the form of the guarantee showed that it was intended to be a joint composite guarantee, contained within a single document which assumed that it would be signed by all of the sureties named in it, then as a starting point in the exercise of construction the guarantee would be regarded as subject to the condition that they all had to sign in order for it to be valid, such that liability would only be imposed on any one signatory if all the others signed. That was so in the instant case, and nothing in the wording of the guarantee excluded that result. Gloster LJ went out of her way to say (at [22]) that:

> "… the authorities do not establish some absolute rule, or enshrined principle, of suretyship that, in all the circumstances, if an intended surety does not sign, the other intended sureties are not bound. It all depends on the construction of the guarantee. The principle of suretyship, which is engaged, is that a surety is entitled to contribution from every co-surety and to the benefit of every security held by the creditor in respect of the debt. If the surety is to be deprived of that right, the guarantee must so provide."

Gloster LJ went on to say (at [23]) that the authorities do establish that if the document, on its face, is intended to be a joint composite guarantee, contained in a single document, which assumes that it will be signed by all the sureties named in it, then the starting point is that the guarantee would be treated as subject to the condition that all proposed sureties should sign in order for it to be valid, and that none is liable thereunder until all do sign. She rejected (at [36], [38], [39]) the proposition that cl.4(a)(iv) would operate to displace that basic reading, on the ground that the provision was about what would discharge a surety who was otherwise liable and not about the a priori question about whether he had ever become validly bound by the terms of the guarantee, which is a different matter.

The same approach was taken in *National Westminster Bank Plc v Alfano* [2013] EWCA Civ 1703. In that case the surety contended that the guarantees he had given were dependent on the bank taking a debenture over the principal debtor's assets, which (he argued) had not occurred. The Court of Appeal, referring to *Gray v TSB* and *Byblos Bank v Al-Khudairy*, re-affirmed the principle that a guarantor who wished to make his guarantee dependent on the giving of security had to show that the condition formed part of the contract of guarantee, and that little short of an

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9 *Dering v Earl of Winchester* (above).

10 See also *Ex p. Gifford* (1802) 6 Ves. Jr. 805 per Lord Eldon LC at 808; *Molson Bank v Kovinsky* [1924] 4 D.L.R. 330 per Orde JA at 336: "But sureties have other rights not based upon contract at all but resulting from the equitable right to contribution in all cases where they are sureties for the same debt, even though bound by different instruments, for different amounts and in different terms. In all such cases the extent of the surety's rights must depend not only upon the terms of the instrument by which the other sureties are bound, and the extent of his relief may be measured by the extent to which the conduct of the creditor has affected the surety's right to contribution."

11 *Ellesmere Brewery Co v Cooper* [1896] 1 Q.B. 75; *Mayhew v Crickett* (1818) 2 Swans. 185; *Pendlebury v Walker* (1841) 4 Y. & C. Ex. 424.

12 *Whiting v Burke* (1870-71) 6 L.R. Ch. App. 342.

13 Although a surety may agree to be bound on the condition that there are co-sureties with him, and of course if this condition is not met that surety may be discharged: *Leaf v Gibbs* (1830) 4 Car. & P. 466; *Evans v Brembridge* (1855) 2 Kay & J. 174. See *James Graham & Co (Timber) Ltd v Southgate Sands* [1986] Q.B. 80; see *Harvey v Dunbar Assets Plc* [2013] B.P.I.R. 722 where a signature of a co-surety was forged.

14 See *Scholefield Goodman & Sons Ltd v Zyngier* [1985] 3 W.L.R. 953. See *Day v Shaw* [2014] EWHC 36 (Ch); [2014] 2 P. & C.R. DG1.

15 See also *Byblos Bank Sal v Al-Khudhairy* [1987] B.C.L.C. 232; *TCB v Gray* [1988] 1 All E.R. 108. Followed in *National Westminster Bank v Alfano* [2012] EWCA Civ 1703.

16 *Greer v Kettle* [1938] A.C. 156.

express term to that effect in the guarantee would do (see Pitchford LJ at [33], [34]).[17]

The right of contribution will apply as a feature of co-suretyship so long as:

(a) the surety and his co-surety have guaranteed a common liability[18];
(b) the surety has paid more, or is about to pay more, than his rateable proportion of the total guaranteed debt,[19] qua surety[20];
(c) the right to contribution has not been contractually excluded or lost.

THE OPERATION OF THE RIGHT OF CONTRIBUTION

When the right to contribution arises

Before payment by the surety: quia timet relief

12-003 Just as the surety is entitled to seek quia timet relief against the principal,[21] so he is entitled to seek quia timet relief against his co-sureties even before he has made payment or incurred a loss under the guarantee.[22] The precise extent of the relief available to the surety prior to his payment of the principal debt is not clear, but the statement of Wright J in *Wolmershausen v Gullick* [1893] 2 Ch. 514 is established authority that a surety can, even before payment, compel his co-sureties to contribute towards the discharge of the common liability.[23] In that case, the executrix of a deceased surety brought quia timet action against co-sureties where the creditor had merely lodged a claim against the deceased's estate for the whole amount of the principal debt. Had the claim been admitted in full, it would have been equivalent to judgment against the estate for the full amount. Wright J granted quia timet relief against the co-sureties, holding that contribution could be effected either by an order that the co-surety pay his proportionate share to the creditor if he is a party to the proceedings, or, where the creditor is not a party, by a prospective order that, upon payment by the surety of his own share, the co-surety indemnify him from further liability.

In *Wolmershausen v Gullick*, Wright J allowed contribution on the basis that the admission of the claim was equivalent to judgment, and a surety against whom judgment had been obtained by the creditor for the full amount (or in any event for more than his rateable share) had a right to contribution from co-sureties. Quite how imminently the surety must be liable to pay the creditor before his right to contribution arises is not wholly clear. Wright J's decision is very wide in ambit, and he was

17 The decision of the Court of Appeal in *Harvey v Dunbar Assets Plc* [2013] EWCA Civ 952; [2013] B.P.I.R. 7202, which had been delivered some four months beforehand, was not cited to or referred to by the Court of Appeal in this case. However, it is likely that the result would have been the same, and the two decisions are consistent.

18 *Coope v Twynam* (1823) Turn. & R. 426 at 429 per Lord Eldon LC.

19 In *Re Snowdon* (1881) L.R. 17 Ch. D. 44, Cotton LJ said: "What we have to decide is whether a surety who has only paid his proportion for the debt for which he is liable can present a bankruptcy petition against his co-surety for contribution. In my opinion he cannot. To entitle him to contribution it is [not] necessary that he should pay more than his proportion of the sum secured by the bond by which he became surety." The word "not" is an obvious error and should be omitted: *Stirling v Burdett* [1911] 2 Ch. 418, per Warrington J.

20 *Trotter v Franklin* [1991] 2 N.Z.L.R. 92 at 102.

21 See Ch.10, paras 10-026–10-029.

22 *Craythorne v Swinburne* (1807) 14 Ves. Jr. 160 at 164; *Wolmershausen v Gullick* [1893] 2 Ch. 514 at 520.

23 See also the remarks of James LJ in *Re Snowdon* (1881) L.R. 17 Ch. D 44 at 47.

prepared (at 529) to make an order that the plaintiff was entitled to enforce contribution "whenever she has paid any sum beyond her share". It seems therefore that the principle upon which a co-surety may be liable to make contribution prior to payment by the surety is flexible enough to entitle the surety to seek a contribution order even though judgment has not yet been obtained by the creditor for the full amount. It has been suggested that it may be enough for the creditor, having a present right to recover the whole debt from the surety, to threaten to do so.[24] Certainly this view was adopted by Orde JA in *Tucker v Bennett* [1927] 2 D.L.R. 42. In *Woolmington v Bronze Lamp Restaurant Pty Ltd* [1984] 2 N.S.W.R. 242, it was held to be sufficient for the surety merely to satisfy the court that he was willing, able and prepared to pay the full amount of the debt.

It is submitted that, strictly speaking, there is no restriction upon the time at which a surety can apply for relief against his co-sureties, provided that the account between the principal and creditor is closed and there is an immediate liability due and payable under the guarantee such that the amount of the contribution can be precisely ascertained. It is immaterial that the creditor has not yet demanded payment, or even that the creditor is obliged under the terms of the guarantee to make a demand before the surety is liable. It is enough that the creditor could enforce the guarantee, either forthwith or after making a demand, for more than the surety's rateable share. This is certainly the case with quia timet relief against the principal for an indemnity,[25] and there is no reason why the same should not apply against the co-surety for contribution.[26] This is entirely consistent with Wright J's approach in *Wolmershausen v Gullick*, since in that case, although the claim in the administration was tantamount to a judgment, there was no immediate and pressing threat of execution which had driven the plaintiff to apply to court: she simply wished to obtain the relief in advance so that she could pay out the creditor when the time came.

The views expressed in the last paragraph above in the second edition of this work have now been approved by the Court of Appeal in *Stimpson v Smith* [1999] Ch. 340.[27] In that case, the plaintiff had, jointly and severally with the defendant as co-surety, guaranteed the liabilities of the principal to the bank. The principal's

24 See Goff and Jones, *The Law of Restitution* (2007), para.4-011 (now 8th edn, 2011 at [36]–[35]), where the new editors suggests that it is enough that "the surety must show that the creditor's right to sue him must have accrued, although he need not show that the creditor intends to sue him straight away: the cloud hanging over him must be 'clearly visible' but need not be 'especially ominous'". The remedy is a discretionary one and there is no hard and fast rule cf. *Rowlatt* (2011), para.7-58. See O'Donovan and Phillips, *The Modern Contract of Guarantee* (1996), pp.624–626, where the argument in favour of the necessity for the surety to have paid prior to being entitled to claim contribution is put forward. See O'Donovan and Phillips, *The Modern Law of Guarantee* (2010), paras 12-155–12-157.

25 See, e.g. the discussion of the cases in *Rowland v Gulfpac Ltd* [1999] Lloyd's Rep. Bank. 86 at 96–99 per Rix J; see also *Papamichael v National Westminster Bank* [2002] 1 Lloyd's Rep. 332; *Sunseeker International Ltd v Tobia* [2011] EWHC 4004 (not a guarantee case).

26 This is the approach adopted in Australia: see *Moulton v Roberts* [1977] Qd. R. 135, where Williams J applied a surety's right to quia timet relief against the principal as stated in *Thomas v Nottingham Football Club Ltd* [1972] Ch. 596 to a claim by the surety for contribution; *Woolmington v Bronze Lamp Restaurant Pty Ltd* [1984] 2 N.S.W.L.R. 242; O'Donovan and Phillips, *The Modern Contract of Guarantee* (1996), pp.625–626. This approach also has support in Canada: see *Agnes & Jennie Mining Co v Zen* [1984] 1 W.W.R. 90. However, in O'Donovan and Phillips, *The Modern Law of Guarantee* (2010) para.12-159 the authors have deleted their suggestion that it is not necessary, for the right of contribution to arise, that the creditor have resort to the guarantee at all provided only that there is a distinct possibility that the creditor may do so. It is not clear why this deletion was made, and it is submitted that the view expressed in the 1996 Australian edition is correct.

27 See per Gibson L.J. at 1300D–H. See the recent application of this principle in *Goldsmith v Revenue and Customs Commissioners* [2012] S.T.I. 3281 (First Tier Tribunal Tax Chamber)

business failed and the bank threatened to put in the receivers. Unknown to the co-surety, the surety negotiated his release from the guarantee in return for a payment by him in reduction of the principal's indebtedness to the bank. He then sued the co-surety for contribution, who objected that the bank had made no demand on the surety and that therefore he was not liable to contribute as co-surety. The Court of Appeal held that the surety was entitled to contribution from the co-surety even though there had been no written demand served by the bank as required by the terms of the guarantee, and even though the co-surety had no knowledge of the payment made by the surety. The amount of the liability the subject-matter of the guarantee was ascertained, or at least easily ascertainable, and a demand under the guarantee could be reasonably anticipated in the absence of a negotiated settlement, and the settlement was not to the co-surety's disadvantage. The requirement of a demand in the guarantee was evidentiary or procedural only, and not a pre-condition of liability under the guarantee, and the surety could waive it without jeopardising his right to claim contribution. Critically, the payment by the surety was not voluntary or officious, viewed commercially in the circumstances which he faced.

Notwithstanding the flexibility of the circumstances in which pre-payment quia timet relief will be granted, it is vital to bear in mind that no such relief will be available unless the right to contribution is present.[28] This depends on a number of matters, not least of which is whether the surety can show that the right has not been excluded or waived, or more importantly, whether he can show that recourse against the principal will be futile.[29] Further, although quia timet relief will be available against co-sureties prior to the surety's having paid the creditor more than his share, he will not be able to enforce an order for contribution against the co-sureties until he has paid.[30]

Where a surety holds an indemnity for his liability under an indemnity bond, he may enforce that indemnity bond after he has been called upon to pay, but before he has actually paid.[31]

After payment by the surety

The general rule: payment in excess of rateable share

12-004 As soon as the surety has paid more than his rateable share of the common liability for the principal debt as between himself and his co-sureties, he is entitled to demand contribution from them in proportion to their respective liabilities.[32] The common liability for the principal debt must be owed by the same debtor.[33] Accordingly, where the burden of a guaranteed debt is assigned with the consent of the creditor, or the creditor assigns the debt, and a new guarantee is taken for it, the new surety cannot seek contribution from the previous surety, because they are not liable on a common demand.[34]

The manner in which co-sureties are bound together for the principal debt will not affect the right of contribution, whether they are bound jointly, severally or

28 As to which see below.
29 Or that this can be inferred: *Hay v Carter* [1935] Ch. 397, and see para.12-007.
30 See the order proposed by Wright J in *Wolmershausen v Gullick* [1893] 2 Ch. 514 at 529.
31 *Wooldridge v Norris* (1868) L.R.6 Eq. 410.
32 *Ex p. Gifford* (1802) 6 Ves. Jr. 805; *Davies v Humphreys* (1840) 6 M. & W. 153; *Re Snowdon* (1881) L.R. 17 Ch. 44; *Stirling v Burdett* [1911] 2 Ch. 418.
33 *Ellesmere Brewery Co v Cooper* [1896] 1 Q.B. 75 at 79.
34 *Ellesmere Brewery Co v Cooper* [1896] 1 Q.B. 75 at 79.

jointly and severally,[35] nor will the fact that they knew nothing of each other's existence at the time they entered the guarantee.[36] It is unnecessary even to show that the different instruments binding the sureties are expressly connected with each other.[37]

The surety is entitled to contribution once his payment exceeds his rateable share even if it is less than the total limit of his liability, but he may not sue his co-sureties for contribution as soon as he has paid simply any part of the principal debt.[38] In *Re Snowdon* (1881) L.R. 17 Ch. D. 44, three sureties had joined in a bond for the principal for £2,000, the liability of each limited to £1,000. The creditor called on one of the sureties under the bond (the principal debt being at that time £1,082) and the surety paid £541, and sought contribution from his co-sureties. The Court of Appeal held that the surety was not entitled to recover. James LJ said (at 46–47):

> "It is impossible to say, when one party has paid part of a debt, until the whole debt is paid in respect of which all the co-sureties are jointly liable, what the right of contribution is … there must be an actual legally ascertainable debt. The co-surety cannot know what is the debt due to him by his co-surety until he knows what has been done in respect of the residue of the debt for which he is equally liable … But, until the whole debt has been paid by one surety, or so much of it as to make it clear that, as between himself and his co-sureties, he has paid all that he can ever be called upon to pay, there can be no equitable debt from them to him in respect of it."

Where the guaranteed debt is payable by instalments, the surety does not acquire a right to contribution by simply paying more than his share of each instalment unless they constitute separate debts or unless each such instalment creates a discrete liability.[39] In *Stirling v Burdett* [1911] 2 Ch. 418, the surety and co-sureties had executed a deed guaranteeing repayment of a mortgage advance, not to be repayable within 10 years, plus premiums and interest. The sureties paid more than their rateable share of premiums and interest, but not of the entire debt, and sought contribution from the co-sureties. Warrington J held that the principal sum, premiums and interest constituted one entire and indivisible debt, and that the sureties were not entitled to contribution, since although they had paid more than their share of premiums and interest, they had not paid more than their share of the whole debt.

Although the essential requirement of the right to contribution is that the surety should pay the creditor an amount in excess of his rateable share, he may also be entitled to contribution where he pays an amount which is not in excess of his rateable share but which is accepted by the creditor in full satisfaction of the whole of the guaranteed liability.[40] It is advisable to give co-sureties an opportunity to consider such a settlement, for this will deprive them later of any defence to a claim for contribution on the grounds that it was an improvident bargain.[41] The rationale is that where the creditor forgives some of the debt in this way equity will

35 *Dering v Earl of Winchelsea* (1787) 2 Bos. & P. 270; *Stirling v Forrester* (1821) 3 Bli. 575 per Lord Redesdale at 590; *Mahoney v McManus* (1981) A.L.J.R. 673 at 675 per Gibbs CJ; cf. *Underhill v Horwood* (1804) 10 Ves. Jr 209 per Lord Eldon. However, the nature of the respective liabilities of the co-sureties inter se may be important in considering the effect of the death or release of one of them: see paras 12-020–12-022 and 12-025.
36 *Dering v Earl of Winchelsea* (1787) 1 Cox Eq. Cas. 318; *Craythorne v Swinburne* (1807) 14 Ves. Jr. 160 at 165.
37 See *Molson's Bank v Kovinsky* [1924] 4 D.L.R. 330 at 335.
38 *Davies v Humphreys* (1840) 6 M. & W. 153; *Re Snowdon* (1881) L.R. 17 Ch. 44.
39 *Re McDonald Ex p. Grant* (1888) W.N. 130; *Stirling v Burdett* [1911] 2 Ch. 418, and see *Halsbury's Laws* (2006), Vol. 49, para.1169, fn.3.
40 *Lawson v Wright* (1786) 1 Eq. Cas. 275; *Re Snowdon* (1881) L.R. 17 Ch. D 44 per James LJ at 47.
41 *Smith v Compton* (1832) 3 B. & Ad. 407. See para.12-019.

redistribute the burden of the debt equally among the co-sureties. Further, a surety who has paid his full share has a right of contribution once he pays anything further.[42] Similarly, where the sureties share a common liability for part of the principal debt, a right of contribution will exist between them in relation to that part. For example, if A guarantees the debt up to a limit of £10,000, and B guarantees the debt without limit, they may claim contribution from each other to the extent of the common liability.[43]

It is always open for the surety to pay the guaranteed debt once it becomes due and then seek contribution, without waiting for any action by the creditor.[44] It appears that there is no requirement in order to found a claim for contribution that the creditor should resort to the guarantee at all before the surety pays under it,[45] provided he is under a present and enforceable liability to the creditor. The payment must be made at least in part out of the surety's own funds or assets, or at least funds or assets treated as such. In *Geopel v Swinden* (1844) 1 Dow. & L. 888, it was held that a surety who was forgiven a debt owing by himself to the principal (as a means of securing the former's rights of indemnity) was not entitled to contribution, having not paid more than the amount forgiven by the principal. This case can be contrasted with *Fahey v Frawley* (1890) 26 L.R. I.R. 78, where the transfer of mortgage security held by the surety was payment giving rise to a right to contribution from co-sureties.

Payment with assistance of third party

12-005 Where payment is made with the assistance of a third party, to whom securities for the guaranteed debt are then assigned by the creditor, the court will treat the surety and the third party as one person, and in making his claim for contribution the surety must account for any amounts received in respect of such securities, net of realisation expenses.[46] This is best illustrated by *Re Arcedeckne* (1883) 24 Ch. D. 709, in which four heirs to landed estates joined as co-sureties for the principal in promissory notes to secure the sum of £13,000 loan and interest. The debt was further secured by policies on the life of the principal for £10,000. One of the four co-sureties, H, then paid off the debt with the assistance of his father by means of a mortgage on the family estates, which were settled on the father as life tenant and on H as remainderman, and obtained an assignment of the policies from the creditor. The father then insured the principal's life for £1,000. The principal then died, and the policy moneys were received by the father. Another co-surety then died, and H sought to be admitted to proof in the administration of his estate for a rateable share of the £13,000 plus interest. It was held that H and his father must be treated as one person for the purposes of claiming contribution, and had to give credit for the £10,000 (net of premiums and expenses) received in respect of the earlier life policies, but not the £1,000 received in respect of the policy taken out by the father.

42 *Davies v Humphreys* (1840) 6 M. & W. 153.
43 As to the amount of the contribution, see paras 12-012–12-014.
44 *Pitt v Purssord* (1841) 8 M. & W. 538.
45 *Moulton v Roberts* [1977] Qd. R. 135.
46 *Re Arcedeckne* (1883) 24 Ch. D. 709.

Payment must be in partial or total discharge of guarantee

12-006 In order to found a right of contribution, the payment by the surety must be made in partial or total discharge of the guaranteed liability.[47] This usually requires that the principal is entitled to receive it.[48] However, it has been suggested that the surety should be entitled to contribution where he has paid the principal in reduction of his liability under the guarantee. In *Mahoney v McManus* (1981) 55 A.J.L.R. 673, this was held to be sufficient to give rise to the right to contribution, even where the amount paid was different from the principal debt and the principal's internal documents showed the payment by the surety as a loan, and not in reduction of the principal debt.

Although the decision has attracted criticism for its application of law to the facts of the case,[49] it is in keeping with the English approach to payments made for specific purposes,[50] and provided the payment to the principal is clearly earmarked as payment for the purposes of discharging the guaranteed liability, the surety will be entitled either to compel the principal to apply it to the principal debt or to restore it to him, depending upon his intentions. In particular, where the surety's object in making the payment to the principal was to save the principal from bankruptcy, and where the surety has an interest of his own, separate from any interest of the principal in seeing that the money is applied towards its stated purpose, the principal will come under a duty to the surety to apply it for such purpose. Upon communication of the arrangement to the creditor, the surety's equitable interest is vested in the creditor, who can enforce the trust and compel payment to himself.[51]

Payment must be made under a legal obligation

12-007 In order to be entitled to contribution, the surety must be under a legal obligation to pay the guaranteed debt, and where the payment is premature or officious, no right to contribution will arise.[52] This is equally true where payment is effected by the realisation of a security given by the surety to the creditor for the guaranteed obligation: accelerated realisation and recoupment by the creditor cannot accelerate the rights of contribution, and the co-sureties are only liable to pay once their own liability under the guarantee has arisen.[53] Further, where the surety makes the payment under a mistake of law as to his obligation to pay, or where there is a valid procedural or substantive defence, at common law he would not be able to recover contribution from his co-sureties.[54] However, the surety may have statutory rights to contribution under the Civil Liability (Contribution) Act 1978 where he can bring

47 As to what constitutes discharge of the principal debt, see Ch.9, paras 9-002–9-010.
48 *Mann v Stennett* (1845) 8 Beav. 189.
49 See O'Donovan and Phillips, *The Modern Contract of Guarantee* (1996), pp.628–629; 2nd English edn (2010), paras 12-164–12-166.
50 *Barclays Bank Ltd v Quistclose Investments Ltd* [1970] A.C. 567; and see P.J. Millett QC, "The Quistclose Trust: Who Can Enforce It?" (1985) 101 L.Q.R. 269; see also *Twinsectra Ltd v Yardley* [2002] 2 A.C. 164, HL. See now Briggs LJ's comprehensive summary of the *Quistclose* trust principles in *Bellis v Challinor* [2015] EWCA Civ 59 at [54]–[66], derived from the other recent cases on the subject.
51 The surety's mandate will remain revocable until communication to the creditor, when it will become irrevocable: see P.J. Millett QC, "The Quistclose Trust: Who Can Enforce It?" (1985) 101 L.Q.R. at 290–291.
52 *Barry v Moroney* (1837) 8 I.R.C.L. 554; *Pawle v Gunn* (1838) 4 Bing. N.C. 445.
53 *McLean v Discount and Finance Ltd* (1939) 64 C.L.R. 312.
54 *Smith v Compton* (1832) 3 B. & Ad. 407; *Pettman v Keble* (1850) 9 C.B. 701.

himself within its requirements.[55] In *Barclays Bank Plc v Miller* [1990] 1 All E.R. 1040, the Court of Appeal described the question of whether the Act applied to contribution claims between co-sureties as a difficult one, and left it open. In *Friends Provident Life Office v Hillier Parker May and Rowden* [1997] Q.B. 85 Auld LJ accorded a very wide meaning to the word "damage" in the 1978 Act and supported the view that the Act may govern contribution claims between co-sureties, particularly where the guarantee is of the principal's performance of his obligations (i.e. a "see to it" guarantee).[56] The Court of Appeal has more recently adopted a wide approach to the construction of the word "damage" in *City Index Ltd v Gawler* [2008] Ch. 313, a case concerned with equitable rights of restitution. However, in *Hampton v Minns* [2002] 1 W.L.R. 1, Kevin Garnett QC decided that if, on a true construction of the guarantee, the obligation of the guarantor sounded in debt rather than in damages, because the surety had promised to pay a sum certain to the creditor on the principal's default, the 1978 Act would have no application. See the extended discussion of this topic at Ch.6, para.6-002.

Principal must be insolvent or otherwise not worth pursuing

12-008 There is one crucially important condition which must be satisfied before the surety can claim contribution from his co-sureties. This is that the surety must demonstrate at least by inference that a claim against the principal would be futile because he is insolvent or otherwise not worth pursuing.[57] This was laid down in *Hay v Carter* [1935] Ch. 397, where the Court of Appeal held that in an action for contribution between co-sureties, the principal should be made a party unless it can be proved or inferred that the principal is insolvent or that there is good reason why he should not be joined.

This is obviously sensible, since it would be inequitable to permit the surety to claim from the co-sureties where the surety retains a right against the principal for an indemnity in respect of the whole of the debt guaranteed. Further, if the principal could fruitfully be joined but is not joined, there would be a risk of proliferation of suits by co-sureties against him, each for an indemnity for their rateable share.[58]

The rule may be seen as a corollary of the rule that the surety must bring into hotchpot for the benefit of his co-sureties any security received from the principal for the guaranteed obligation, as to which see para.12-016.

When the right to contribution does not arise

12-009 Generally, the right to contribution will not arise where the factors mentioned above are not satisfied. For example, there is no right of contribution where the co-

[55] In order to invoke the assistance of that Act, the surety must show that his liability arose out of a claim in damages as opposed to debt. Although the orthodox view is that a claim under a guarantee generally sounds in damages and not in debt (*Moschi v Lep Air Services* [1973] A.C. 331), this is in modern times not an invariable rule: see *Hampton v Minns* [2002] 1 W.L.R. 1 and now the decision of the Court of Appeal in *McGuinness v Norwich and Peterborough Building Society* [2012] EWCA Civ 265 (and the detailed discussion at para.6-002 above).

[56] See Goff and Jones, *The Law of Restitution* (2007), para.14-003; and see now Goff and Jones, *The Law of Unjust Enrichment* (2011), paras 19-30–19-33, concluding that, contrary to *Friends Provident Life Office v Hillier Parker May and Rowden* [1997] Q.B. 85, the Act does not confer a claim to contribution on parties whose liability arose in unjust enrichment; but that co-sureties may nevertheless be entitled to claim contribution under the Act depending on whether their liability sounds in debt or damages.

[57] See Goff and Jones, *The Law of Restitution* (2007), paras 14-009–14-011; *Lawson v Wright* (1786) 1 Cox Eq. Cas. 275 per Lord Kenyon; *Hay v Carter* [1935] Ch. 397 CA.

[58] *Craythorne v Swinburne* (1807) 14 Ves. Jr. 160.

sureties are not subject to a common demand,[59] nor where the sureties are bound by different instruments for different and distinct portions of the same debt due from the principal, where each suretyship is a separate and distinct transaction,[60] nor where the surety has not paid more than his rateable share.[61] This also applies where the surety's contract of guarantee has stipulated that each is only to be individually liable for a particular portion of the principal debt,[62] and where the sureties limit their liabilities under the guarantee, they cannot be compelled to pay more than that limit.[63] The court will look at the substance of the transaction, and what exactly the parties had guaranteed and not merely the fact that the instruments were separate.[64]

There is no right of contribution where the sureties guarantee different debts or obligations of the principal.[65] Where A, therefore, guarantees repayment of the principal's overdraft, and B guarantees repayment of a separate overdraft of the principal, no right of contribution will lie between A and B. Equally, where sureties have guaranteed separate and distinct portions of the same principal debt, there is no right of contribution between them.[66]

There is no right of contribution where the surety induced the co-surety to assume liability by means of a fraud. However, there is no general duty of disclosure between co-sureties, and so the surety is not obliged to inform his co-sureties of any dealings he has with the principal, for example the existence of a debt owed to him by the principal.[67] Further, the right to contribution will not (or is said not to) arise in two particular instances.

Against persons not co-sureties

12-010 The right to contribution will not arise where there is no relationship of co-surety inter se. A surety who has his own obligations under the guarantee guaranteed in turn by a sub-surety is not entitled to seek contribution from that sub-surety upon payment to the creditor.[68] The position is that the sub-surety does not occupy the position of co-surety in a common liability with the surety, but as guarantor for the obligations of the surety, who is the principal for that purpose. Although the sub-surety cannot be made liable for contribution to the surety, he can claim an indemnity from his surety in prior degree, and be subrogated to the creditor's securities and rights against that surety.[69] This was vividly illustrated in *Day v Shaw* [2014] P. & C.R. DG1. In that case the debts of a company to the bank had been guaranteed jointly and severally by two directors, S and X. One of the directors (S) and his wife (Mrs S) had also granted a second mortgage to the bank over their property in respect of all moneys due from them to the bank (i.e., in reality from S as guarantor under the joint and several guarantee). The company went into liquidation and X went bankrupt. The property was sold and the bank was repaid its debt. However, the claimant, D, had separately lent money to S which had

[59] *Hunter v Hunt* (1845) 1 C.B. 300; *Johnson v Wild* (1890) 44 Ch. D. 146 (an indemnity case); *American Surety Co of New York v Wrightson* (1910) 103 L.T. 663 at 665 per Hamilton J.

[60] *Coope v Twynam* (1823) Turn. & R. 426.

[61] *Re Snowdon* (1881) L.R. 17 Ch. D 44.

[62] *Pendlebury v Walker* (1841) 4 Y. & C. Ex. 424.

[63] *Dering v Earl of Winchelsea* (1787) 2 Bos. & P. 270.

[64] *Davies v Humphreys* (1840) 6 M. & W. 153.

[65] *Coope v Twynam* (1823) 1 Turn. & R. 426; *Dering v Earl of Winchelsea* (1787) 1 Cox Eq. Cas. 318.

[66] *Pendlebury v Walker* (1841) 4 Y. & C. Ex. 424: *Coope v Twynam* (1823) 1 Turn. & R. 426.

[67] *Mackreth v Walmesley* (1884) 51 L.T. 19.

[68] *Craythorne v Swinburne* (1807) 14 Ves. Jr. 160; *Re Denton's Estate* [1904] 2 Ch. 178; *Ward v National Bank of New Zealand* (1883) 8 App. Cas. 755.

[69] See Ch.11, para.11-022 and *Fox v Royal Bank of Canada* (1975) 59 D.L.R. (3d) 258.

not been repaid, and he obtained a charging order against S's share of the property. The question was whether Mrs S had an equity of exoneration in respect of S's share of the property which could defeat D's claim to enforce his charging order against that share. Morgan J analysed the positions of the parties and decided that S and X were the guarantors of the company's liability and that S and Mrs S, as mortgagors, were sub-sureties guaranteeing the liability of S1 and X under the guarantee. As such, S and Mrs S as sub-sureties were entitled to be indemnified by S and X as guarantors. Although overall the company was the principal debtor, as between guarantors and mortgagors the guarantors were the principal debtor (see [26]). Therefore Mrs S could establish that she had a right to be indemnified by S in relation to the debt owed to the bank, and that since her liability had arisen by granting a mortgage to secure his debt, she had an equity of exoneration that was not merely a personal right but a proprietary right against his share in the property which had priority over D's charging order (see [30]).

Where, on the true construction of his contract, a person is not a co-surety but jointly liable as co-debtor, there will be no right of contribution,[70] although the surety may have a right to contribution under the Civil Liability (Contribution) Act 1978, if he can bring himself within its terms.[71]

Where a bill of exchange is given as security for a debt, both the drawer and the acceptor are sureties vis-à-vis the principal, but as between themselves, the drawer is surety only for the acceptor. In the absence of agreement the acceptor bears the primary obligation with no right of contribution against the drawer.[72]

Co-suretyship at the request of the surety: Turner v Davies

12-011 There is also authority for the proposition that there is no right to contribution where the co-surety assumes the position as such at the request of the surety. In *Turner v Davies* (1796) 2 Esp. 478, Lord Kenyon said: "there is no pretence for saying that he shall be liable to be called upon by the person at whose request he entered into the surety".[73] However, this purported rule has been doubted by more recent writers,[74] and is difficult to square with the classic statements of principle in relation to contribution from co-sureties: that if the surety and the co-surety are liable for the same debt in a common demand, there is no reason why the obligation to pay contribution should not apply where one surety becomes bound at the request of another.[75] *Turner v Davies* may be explicable on the basis that in that case the surety had received security from the principal in respect of his liability under the guarantee, and if this had been given with a view to discharging the surety then no right of contribution would have arisen.[76]

Of course, the court will be astute to ascertain whether the co-surety did actually become a co-surety, and if there are circumstances, such as the taking of a

[70] *Re Denton's Estate* [1904] 2 Ch. 178.
[71] See fn.52.
[72] *Ex p. Hunter* (1825) 2 Gl. & J. 7.
[73] (1796) 2 Esp. 478 at 479.
[74] See Goff and Jones, *The Law of Restitution* (2007), para.14-007 (comment not repeated in 8th edn, 2011); McGuinness, *The Law of Guarantee* (1996) para.9.09, 3rd edn (LexisNexis Canada, 2013), para.10.130; O'Donovan and Phillips, *The Modern Contract of Guarantee* (1996), pp.622–623; 2nd English edn (2010), para.12-151.
[75] Note that there is no principle that the surety should not be entitled to an indemnity where he assumes the role as such at the request of the principal, which would be the case, by analogy, if Lord Kenyon's statement in *Turner v Davies* (above) were correct.
[76] *Done v Walley* (1848) 2 Ex. 198; and see the cases discussed in relation to the hotchpot rule in para.12-016.

security by the surety from the purported co-surety, which suggest that in fact the latter is a sub-surety, contribution will not be available to the surety. This may afford another explanation of *Turner v Davies*.

Modification or exclusion

12-012 It is clear that a surety can modify or exclude his right to contribution by express agreement with his co-sureties.[77] Such an agreement will not affect the rights of the creditor.[78] An agreement to modify or exclude the surety's rights of contribution can be vitiated on the grounds of fraud or fraudulent concealment,[79] or a failure to satisfy a condition precedent.[80] An agreement between the surety and the co-surety that the surety would indemnify the co-surety against any liability to which he might be exposed as a result of giving the guarantee operates to exclude the surety's right of contribution.[81] It has been held in Australia that a provision in the guarantee itself that the surety will not "make a claim or enforce" the right of contribution will be effective to vary the surety's equitable rights, but not to oust the court's jurisdiction: *Hongkong Bank of Australia Ltd v Larobi Pty Ltd* (1991) 23 N.S.W.L.R. 593.[82]

The right of the surety to recover contribution from his co-surety may be excluded or restricted by the nature of the obligation assumed by that co-surety. Where the co-sureties have each contracted, in distinct instruments, to be liable for the guaranteed obligation in a particular sum, there is no right of contribution.[83] Similarly, where the co-sureties all agree that one of their number shall pay the first tranche of the principal debt, or where liability is not distributed equally between them, the right to contribution will be excluded.[84] However, an express clause in one guarantee limiting or excluding the right to contribution will not affect the rights of contribution of the co-sureties where they are sureties for the same principal and principal debt under a different instrument which does not exclude or limit such rights.

Since its origin lies in equity, and not the contractual relationship of the parties, the court will be slow to imply a term to the effect that the surety has abandoned his rights of contribution. However, it is possible to infer from the conduct of the surety an intention on his part to abandon such rights. For example, where the surety fails to perform his duties towards his co-sureties, for example by refusing to bring security into hotchpot or by joining the co-surety in suing the principal for an indemnity, he may be taken to have waived or abandoned his rights of contribution.[85]

[77] *Craythorne v Swinburne* (1807) 14 Ves. Jr. 160; *Dering v Earl of Winchelsea* (1787) 2 Bos. & P. 270; *Pendlebury v Walker* (1841) 4 Y. & C. Ex. 424; *Arcedeckne v Howard (Lord)* (1872) 27 L.T. 194, affirmed (1875) 45 L.J. Ch. 622 HL.
[78] See *Bater v Kare* [1964] S.C.R. 206; *Hampton v Minns* [2002] 1 W.L.R. 1.
[79] *Mackreth v Walmesley* (1884) 51 L.T. 19 at 30 per Kay J. The surety's obligations of disclosure to the co-sureties are no greater than those of the creditor to them.
[80] *Re Arcedeckne, Arcedeckne v Lord Howard* (1875) 45 L.J. Ch. 622.
[81] *Rae v Rae* (1857) 6 I. Ch. R. 490.
[82] See also *Bond v Larobi Pty Ltd* (1992) 6 W.A.R. 489.
[83] *Coope v Twynam* (1823) Turn. & R. 426; *Pendlebury v Walker* (1841) 4 Y. & C. Ex. 424; *Re Denton's Estate* [1904] 2 Ch. 178.
[84] *Molson's Bank v Kovinsky* [1924] 4 D.L.R. 330.
[85] *Steel v Dixon* (1881) 17 Ch. D. 825. As to hotchpot, see para.12-016.

The amount of contribution

The principal amount

12-013 The rule at common law was that each surety was liable for his own share and his right to contribution depended on the number of co-sureties, irrespective of the insolvency of any co-surety.[86] In equity, the rule was that the amount of contribution depended upon the number of solvent sureties at the time when the contribution was sought, and this is now the prevailing rule.[87]

The general rule is that all the sureties are liable to contribute equally towards the common debt, and if they are not liable in equal proportions, then they must contribute a pro rata amount.[88] Accordingly, where co-sureties guarantee the whole of the principal debt but their liabilities are limited to certain amounts, they share the burden of the principal debt on the basis of the proportion of their maximum liability. In *Ellesmere Brewery Co v Cooper* [1896] 1 Q.B. 75, the liabilities of the four sureties were limited to £50 each as to two sureties and £25 each as to the other two. Had they been liable for contribution, where one surety paid out £48, the £50 sureties would have borne £16 each as their rateable share and the £25 sureties would have borne £8 each.

Matters are more complex where, on the other hand, the sureties guarantee different parts of the common debt. Assume that A, B and C each guarantee a debt of £1,000 in the proportions £200, £300 and £500, and that they are truly co-sureties for the same debt. Where, for example, the creditor accepts £500 from C in satisfaction of the entire debt, it would appear that A and B would have to contribute £100 and £150, being the proportion of the payment made by the surety which their maximum liability bore to the entire guaranteed debt.[89]

The insolvency of a co-surety will affect the rights of contribution of the remaining co-sureties. Thus where A, B and C are sureties for a debt of £600, and both the principal and A become insolvent, B and C are liable to contribute in equal proportions, and if C pays the whole debt, he can recover £300 from B (rather than £150 from each of A and B, which is what he would be entitled to if A were solvent). Where A, B and C agree to bear the debt in proportions of respectively £150, £300 and £150, then C may recover £400 from B, £300 being his own share plus £100 (two-thirds of A's share of £150). The two-thirds represents the 2:1 ratio which B's share bears to C's share.[90]

It has often been said that the effect of the equitable rule is that only solvent co-sureties are obliged to contribute.[91] What this actually means is that it is the solvent co-sureties who bear the initial burden of contribution, and the estate of the

[86] *Cowell v Edwards* (1800) 2 Bos. & P. 268; *W. R. Browne v Lee* (1827) 6 B. & C. 689. It seems that the number of sureties was taken as at the time when the guarantee was given, and not when the payment was made: *Batard v Hawes* (1853) 2 E. & B. 287.

[87] *Hitchman v Stewart* (1855) 3 Drew. 271; *Lowe v Dixon* (1885) 16 Q.B.D. 455.

[88] *Dering v Earl of Winchelsea* (1787) 1 Cox Eq. Cas. 318; *Pendlebury v Walker* (1841) 4 Y. & C. Ex. 424 at 441 per Alderson B; *Ellesmere Brewery Co v Cooper* [1896] 1 Q.B. 75; *Coope v Twynam* (1823) Turn. & R. 426; *Re MacDonaghs* (1876) 10 Ir. Eq. 269.

[89] See *Ellesmere Brewery Co v Cooper* [1896] 1 Q.B. 75; and see *Ellis v Emmanuel* (1876) 1 Ex. D. 157, where at 162 Blackburn J indicated that the limits put upon each surety's share of the guaranteed debt would affect the amount which each was liable to contribute, without saying exactly how. See further *Re MacDonaghs* (1876) 10 Ir. Eq. 269 and *Commercial Union Assurance Co Ltd v Hayden* [1977] Q.B. 804 at 815.

[90] See *Pendlebury v Walker* (1841) 4 Y. & C. Ex. 424; *Ellesmere Brewery Co v Cooper* [1896] 1 Q.B. 75 at 81 per Lord Russell CJ; *Re Price* (1978) 85 D.L.R. (3d) 554. [

[91] *Ellesmere Brewery Co v Cooper* [1896] 1 Q.B. 75 at 81; *Mahoney v McManus* (1981) 55 A.J.L.R. 673.

insolvent co-surety remains liable to contribute, the obligation being a provable debt, although the rule against double proof will prevent the surety who has not paid the whole of the guaranteed debt from proving for the amount for which the creditor is entitled to prove.[92] Where the surety proves in the co-surety's bankruptcy, he will be obliged to share any dividends he receives with his co-sureties, or give credit for them, in rateable proportions equivalent to their share, or equally if they remain equally liable.[93]

Interest

12-014 The surety can recover interest from his co-surety on the sum due for contribution: interest will run from the date on which the surety paid the creditor more than his due share.[94] It is immaterial that the principal debt did not carry interest.[95] Further, it seems that a surety who has paid his share is able to compel his co-sureties to exonerate him from further interest accruing to the creditor on his co-sureties' unpaid shares.[96]

Costs

12-015 The surety cannot as a rule recover as part of his claim for contribution his costs of defending an action against him by the creditor,[97] unless either he was specifically authorised by the co-sureties to defend the action or he was prudent and reasonable in doing so.[98] Where by defending the claim the common liability of the co-sureties is materially reduced, the surety may recover these costs in contribution from his co-sureties.[99] However, if a surety raises a defence that is personal to himself, he will not be entitled to his costs by way of contribution, because his defence has not and could not have led to any relief of his co-sureties.[100]

The right of the surety to securities

Subrogation to creditor's securities

12-016 A surety who has paid more than his rateable share of the common liability is entitled to have assigned to him all the creditor's rights and securities, whether satisfied or not, for the purpose of obtaining contribution,[101] and this includes securities received by the creditor from co-sureties for the guaranteed obligation.[102] This is because once the creditor has been paid by the surety, he is bound in equity to

[92] See para.12-024.

[93] See *Re Hendry Ex p. Murphy* [1905] S.A.L.R. 116.

[94] *Lawson v Wright* (1786) 1 Cox. Eq. Cas. 275; *Hitchman v Stewart* (1855) 3 Drew. 271; *Re Swan's Estate* (1869) I.R.Eq. 209; *Re Fox, Walker Ex p. Bishop* (1880) 15 Ch. D. 400; and see *Petrie v Duncombe* (1851) 2 L.M. & P. 107 as to interest payable in respect of the principal debt.

[95] *Re Swan's Estate* (1869) 4 Ir. Eq. 209.

[96] *Rowlatt on the Law of Principal and Surety* (2011), para.7-63.

[97] *Knight v Hughes* (1828) 3 Car. & P. 467; *Roach v Thompson* (1843) 5 Man. & G. 405.

[98] *Tindall v Bell* (1843) 11 M. & W. 228; *Kemp v Finden* (1844) 12 M. & W. 421; *Broom v Hall* (1859) 7 C.B. N.S. 503; *Williams v Buchanan, Anderson Third Party* (1891) 7 T.L.R. 226 at 27 per Lord Esher; *The Millwall* [1905] P. 155. See the doubts expressed in Goff and Jones, *The Law of Restitution* (2007), para.14-013, fn.74.

[99] *Wolmershausen v Gullick* [1893] 2 Ch. 514 at 529–530.

[100] *International Contract Co, Hughes' Claim, Re* (1871-72) L.R. 13 Eq. 623 at 625 per Wickens VC; *South v Bloxham* (1865) 2 Hem. & M.457.

[101] As to the surety's right of subrogation, see Ch.11, paras 11–017 and following.

[102] *Ex p. Crisp* (1744) 1 Atk. 133 at 135; *Greenside v Benson* (1745) 3 Atk. 248; 27 E.R. 849; *Stirling v Forrester* (1821) 3 Bli. 575 at 590 per Lord Redesdale; *Duncan Fox & Co v North & South Wales*