The interest of the bank as mortgagee should at least be noted on the policy, although this alone provides limited protection to a lender. The insurance company may, if requested by a lender, agree to inform the bank if it receives a claim and, provided the insurance moneys are expressed in the security document to be charged to or held on trust for the bank, it will be able to claim them. Banks may feel the present position concerning insurances effected by mortgagors could usefully be improved by the adoption by the insurance market of a standard mortgagee clause. The following is suggested as a mortgagee interest clause:

> 'This insurance shall not be prejudiced by any act of the mortgagor or occupier of any building insured hereby provided the mortgagees shall immediately on becoming aware thereof give notice in writing to the insurer and shall pay such reasonable additional premiums as may in consequence be required.'

For high value assets, the lender may be better served by insisting upon co-insurance in its favour. This will of course result in additional costs.

## SEARCHES AT RELEVANT SPECIALIST REGISTRIES

1.34 If the assets of the company include other assets which are subject to special registration regimes then steps should be taken by the bank to ensure those other registers that are of relevance are searched. This is important not only to determine whether there may be a third party with an interest in any of those assets, but also to ensure that the company's own title is adequately established by proper registration where necessary. Important examples of such assets include aircraft, ships and other maritime vessels, patents, registered trademarks and registered designs.

1.35 Finally, regard must be had to the matters set out in the remainder of Part I, **CH 2–CH 6**.



Chapter 2

# MINUTES

2.1 Some banks choose not to involve themselves with the formalities of the meetings at which their security is created, preferring instead to rely on the rule in *Royal British Bank v Turquand*[1] and on the Companies Act 2006, ss 39 and 40. Others call for certified extracts from the minutes with a view to ensuring that appropriate resolutions have been passed.

The writer's view is that it remains good practice to call for certified extracts from the minutes in some such form as is set out at the end of this chapter because in extreme cases no board seal or executed by two directors or a director and the secretary or a joint secretary of a seal or executed by two directors or a director and the secretary or a joint secretary of a company (or, in relation to documents executed on or after 6 April 2008, by a director of a company in the presence of a witness who attests the signature) the bank may be saved by ss 74 and 74A of the Law of Property Act 1925 or ss 44 and 46 of the Companies Act 2006 (see para **2.5** et seq).

However, if the bank has received certified minutes of a purported board meeting, the company may be estopped from denying a board meeting was held (*TCB Ltd v Gray*[2]). Browne-Wilkinson V-C said:

> 'In my judgment L, having put forward the minutes of the meeting as one of the completion documents on the basis of which TCB made the loan, could not be heard to challenge the validity of that minute by denying that such meeting ever took place. Therefore the minute stands as irrefutable evidence against L that the grant of the debenture was a 'transaction decided on by the directors'. Accordingly the necessary basis for section 9(1) of the Act of 1972 to apply, as between L and TCB, exists. It follows that the debenture was valid.'

It is questionable whether such estoppel will necessarily bind a liquidator of the company (*Re Exchange Securities and Commodities Ltd*[3]).

Occasionally, company secretaries produce minutes which show that they (and possibly the board) have misunderstood the nature of the security created. Badly-drawn minutes or the absence of minutes naturally excite the attention of liquidators when in the course of their duties they call for and examine the minute book of the company. The importance of observing correct procedures in taking security is illustrated by *Rolled Steel Products (Holdings) Ltd v British Steel Corpn*[4] (see para **4.6**).

Bankers often have detailed actual knowledge of the affairs of their customers, and it is well established that notice of irregularities removes any protection given by the rule in *Turquand* and may even take a bank outside the protection conferred by s 40 of the Companies Act 2006. The problem for large

organisations such as banks is that those responsible for taking the security may be unaware of the irregularities and their colleagues who are aware may not appreciate the significance of what they learn. Although the existence of 'good faith' was assumed by the Court of Appeal in *Smith v Henniker-Major & Co*[5] (and the case concerned a director of the very company in question seeking protection under the provisions of s 35A of the Companies Act 1985), it is clear that the courts will give little assistance to a third party who is directly concerned with overstepping the limitations upon the authority of directors and others contained in the company's constitution.

1 (1856) 6 E & B 327.
2 [1986] Ch 621 at 637, CA.
3 [1988] Ch 46, [1987] 2 All ER 272 and see also the observations of Neuberger J in *Re Harvard Securities Ltd* [1997] 2 BCLC 369 at 386.
4 [1986] Ch 246, [1985] 3 All ER 52, CA.
5 [2002] EWCA Civ 762, [2003] Ch 182.

## ROYAL BRITISH BANK V TURQUAND

**2.2** Under the rule in *Royal British Bank v Turquand*[1], third parties dealing with the company were deemed to have notice of the public documents of the company filed at the Companies Registry but this assumption was materially modified by the Companies Act 1985, new ss 35 to 35B, now contained in a modified form in the Companies Act 2006, ss 39 and 40 (para **2.7** et seq). Third parties acting in good faith are absolved from enquiring into internal irregularities unless they have notice of the irregularity or are put upon enquiry and would have discovered the irregularity had due enquiries been made (see *Morris v Kanssen* per Lord Simonds[2]).

In *Rolled Steel Products (Holdings) Ltd v British Steel Corpn*[3] at 283 and 284, Slade LJ explained the qualification in *Turquand's* case about notice of irregularities in these terms:

> 'However, [ss 39 and 40 of the Companies Act 2006] apart, persons dealing with a company registered under the Companies Acts must be taken not only to have read both the memorandum and articles of a company but to have understood them according to their proper meaning . . .
>
> 'It is a rule which only applies in favour of persons dealing with the company in good faith. If such persons have notice of the relevant irregularity, they cannot rely on the rule.'

He added at 292:

> 'Nevertheless, as a general rule, a company incorporated under the Companies Acts holds out its directors as having ostensible authority to do on its behalf anything which its memorandum of association expressly or by implication gives the company the capacity to do . . . In the absence of notice to the contrary, the lenders would thus have been entitled to assume, on the authority of the principle in *Turquand's* case, and on more general principles of the law of agency, that the directors of the borrowing company were acting properly and regularly in the internal management of its affairs . . . However, a party dealing with a company cannot rely on the ostensible authority of its directors to enter into a particular transaction if it knows they in fact have no such authority because it is being entered into for improper purposes. Neither the rule in *Turquand's* case nor more general principles of the law of agency will avail him in such circumstances.'





In *Gloucester County Bank v Rudry Merthyr Steam and House Coal Colliery Co*[4], a person dealing with the company obtained a mortgage under seal signed by two directors and the secretary. In fact, there was no quorum present at the board meeting at which the mortgage was executed but it was held that the mortgage was valid. Lord Halsbury[5] said:

> 'The only external fact with respect to the management of the company of which an outside person would be cognisant would be that they had power to make any quorum they pleased, and I think he would be entitled to assume that the proper quorum had been properly summoned and had attended . . . '

A third party may be put upon enquiry by reason of the unusual nature of the transaction, and in particular if the transaction is outside the ostensible authority of the officer carrying it out.

In *Freeman & Lockyer v Buckhurst Park Properties (Mangal) Ltd*[6], Willmer LJ summarised the effect of earlier authorities by quoting the following from an earlier report[7]:

> 'If the articles merely empower the directors to delegate to an officer authority to do the act, and the officer purports to do the act, then, if the act is one which would ordinarily be beyond the powers of such an officer, the plaintiff cannot assume that the directors have delegated to the officer power to do the act; and if they have not done so, the plaintiff cannot recover.'

It is crucial to know when a bank is and when it is not on enquiry. Anything out of the ordinary may suffice to defeat the protection of the rule in *Turquand*. For example, if a charge is taken over documents from time to time deposited within a bank, the bank will be put on enquiry if documents are lodged by some junior official acting outside his ostensible authority. In *Rolled Steel Products (Holdings) Ltd v British Steel Corpn* Slade LJ said that the very nature of a proposed transaction may put a person upon enquiry as to the authority of the directors of a company to effect it, the issue depending on all the particular circumstances.

1 (1856) 6 E & B 327.
2 [1946] AC 459 at 475, HL.
3 [1986] Ch 246, [1985] 3 All ER 52, CA.
4 [1895] 1 Ch 629.
5 [1895] 1 Ch 629 and 633, CA.
6 [1964] 2 QB 480 at 496, CA.
7 *British Thomson-Houston Co Ltd v Federated European Bank Ltd* [1932] 2 KB 176 at 184.

## STATUTORY PROTECTION

**2.3** The old cases must now be read in the light of s 74 of the Law of Property Act 1925 as amended and ss 39 and 40 of the Companies Act 2006 (which have in some respects altered the impact of ss 35 to 35B of the Companies Act 1985 discussed in relevant earlier editions of this work). Section 74(1), (1A) and (1B) of the Law of Property Act 1925 enact:

> (1) In favour of a purchaser an instrument shall be deemed to have been duly executed by a corporation aggregate if a seal purporting to be the corporation's seal purports to be affixed to the instrument in the presence of and attested by:

(a) two members of the board of directors, council or other governing body of the corporation, or

(b) one such member and the clerk, secretary or other permanent officer of the corporation or his deputy.

(1A) Subsection (1) of this section applies in the case of an instrument purporting to have been executed by a corporation aggregate in the name or on behalf of another person whether or not that person is also a corporation aggregate.

(1B) For the purposes of subsection (1) of this section, a seal purports to be affixed in the presence of and attested by an officer of the corporation, in the case of an officer which is not an individual, if it is affixed in the presence of and attested by an individual authorised by the officer to attest on its behalf.'

The Law of Property Act 1925, s 205, defines 'purchaser' in the following terms:

> '"Purchaser" means a purchaser in good faith for valuable consideration and includes a lessee, mortgagee or other person who for valuable consideration acquires an interest in property . . . and in reference to a legal estate includes a chargee by way of legal mortgage; and where the context so requires "purchaser" includes an intending purchaser . . . and "valuable consideration" includes marriage, and formation of a civil partnership, but does not include a nominal consideration in money.'

It will be seen that s 74 extends to bank security documents under seal but only to documents under seal. It confers protection if the seal is attested by persons purporting to hold the office of secretary and director or two directors even if they do not in fact hold such office. It should be noted that notwithstanding the amendment of s 74 by the Regulatory Reform (Execution of Deeds and Documents) Order 2005[1], in relation to documents under seal executed before 15 September 2005, the previous form of s 74 whereby attestation by a permanent officer such as the secretary is required and attestation by two directors is *not* sufficient still applies (see however para **2.4** below).

[1] SI 2005/1906.

**2.4** The abolition of the need for a seal by s 36A(3) of the Companies Act 1985 (now s 45(1) of the Companies Act 2006) made it necessary to supplement the protection conferred by s 74. The former s 36A(6) (as amended in 2005) enacted:

> '(6) In favour of a purchaser a document shall be deemed to have been duly executed by a company if it purports to be signed by a director and the secretary of the company, or by two directors of the company.
>
> 'A "purchaser" means a purchaser in good faith for valuable consideration and includes a lessee, mortgagee or other person who for valuable consideration acquires an interest in property.'

Section 36A(6) conferred similar protection to the Law of Property Act 1925, s 74 not only to deeds executed without a seal but to any document which purported to be signed by a director and the secretary or by two directors of the company. Signature by persons purporting to be two directors of the company sufficed, whereas under s 74, in relation to instruments under seal executed prior to 15 September 2005, one of the signatories had to purport to





hold the office of a permanent officer such as the secretary. However, s 36A(6) unlike s 74 did not extend to signature by a deputy secretary. The definition of 'purchaser' remained unchanged.

**2.5** In relation to documents[1] executed on or after 6 April 2008, it is now necessary to consider due execution in the light of the Companies Act 2006, s 44. That section relevantly provides as follows:

> '44
>
> . . .
>
> (2) A document is validly executed by a company if it is signed on behalf of the company—
>
> (a) by two authorised signatories, or
>
> (b) by a director of the company in the presence of a witness who attests the signature.
>
> (3) The following are "authorised signatories" for the purposes of subsection (2)—
>
> (a) every director of the company; and
>
> (b) in the case of a private company with a secretary or a public company, the secretary (or any joint secretary) of the company.
>
> . . .
>
> (5) In favour of a purchaser a document is deemed to have been duly executed by a company if it purports to be signed in accordance with subsection (2)[2].
>
> A "purchaser" means a purchaser in good faith for valuable consideration and includes a lessee, mortgagee or other person who for valuable consideration acquires an interest in property.
>
> . . . '

The definition of 'purchaser' still remains unchanged. A comparison with the previous provision set out in para **2.4** readily shows that the protection formerly afforded by s 36A(6) of the 1985 Act has been extended to encompass documents signed on behalf of a company by a single director in a presence of a witness who attests the signature.

[1] A 'document' in this context includes all documents including informal ones such as notices: see *Hilmi & Associates Ltd v 20 Pembridge Villas Freehold Ltd* [2010] 3 All ER 391, [2010] 1 WLR 2750, CA.

[2] A document may 'purport' to be so signed even where one director forges the signature of another: *Lovett v Carson Country Homes Ltd* [2009] EWHC 1143 (Ch), [2011] BCC 789.

**2.6** Like ss 40 and 44 of the Companies Act 2006, protection under s 74 of the Law of Property Act 1925 only exists if the purchaser is in good faith. Any third party who has actual notice of irregularities will fail this test. The meaning of 'good faith' in the context of the older law regarding corporate capacity was considered in *International Sales and Agencies Ltd v Marcus*, in which Lawson J held[1]:

> ' . . . the test of the lack of . . . good faith in somebody entering into obligations with a company will be found either in proof of his actual knowledge that the transaction was ultra vires the company or where it can be shown that such a person could not in view of all the circumstances, have been unaware that he was a party to a transaction ultra vires.'

Further assistance can be derived from the remarks of Lord Herschell in *London Joint Stock Bank v Simmons*[2] where he considered the meaning of 'good faith' in relation to negotiable instruments:

> 'I should be very sorry to see the doctrine of constructive notice introduced into the law of negotiable instruments. But regard to the facts of which the taker of such instruments had notice is most material in considering whether he took in good faith. If there be anything which excites the suspicion that there is something wrong in the transaction, a taker of the instrument is not acting in good faith if he shuts his eyes to the facts presented to him and puts the suspicions aside without further inquiry.'

The question of good faith was further considered in the unreported case of *Re Rapierway Ltd*[3]. Peter Gibson J held that failure to make a company search before making a loan might be regarded as somewhat careless but certainly did not constitute lack of good faith. He cited *Midland Bank Trust Co Ltd v Green* where Lord Wilberforce said[4]:

> 'I think that it would generally be true to say that the words "in good faith" related to the existence of notice. Equity, in other words, required not only absence of notice, but genuine and honest absence of notice.'

Peter Gibson J commented that:

> 'Genuine and honest absence of notice must, I think, also comprehend that the purchaser is not a person who shuts his eyes to the truth. Thus if the purchaser were put on enquiry but avoided making such enquiries, it may well be that he could not be said to be a purchaser in good faith.'

However, the courts will be reluctant to import constructive notice into the test of good faith particularly if the Companies Act 2006, ss 39 and 40 apply (*TCB Ltd v Gray*[5]).

1 [1982] 3 All ER 551 at 559.
2 [1892] AC 201 at 221, HL.
3 Unreported, 17 May 1989, Ch D.
4 [1981] AC 513 at 528, HL.
5 [1986] Ch 621, [1986] 1 All ER 587; affirmed on appeal [1987] Ch 458, [1988] 1 All ER 108, CA.

2.7 The Companies Act 2006, by ss 39 and 40 (replacing with some modification ss 35 to 35B of the 1985 Act) provides:

'39

(1) The validity of an act done by a company shall not be called into question on the ground of lack of capacity by reason of anything in the company's constitution.

(2) This section has effect subject to section 42 (companies that are charities).

40

(1) In favour of a person dealing with a company in good faith, the power of the directors to bind the company, or authorise others to do so, is deemed to be free of any limitation under the company's constitution.

(2) For this purpose—

(a) a person "deals with" a company if he is a party to any transaction or other act to which the company is a party,

(b) a person dealing with a company—

(i) is not bound to enquire as to any limitation on the powers of the directors to bind the company or authorise others to do so.

(ii) is presumed to have acted in good faith unless the contrary is proved, and





(iii) is not to be regarded as acting in bad faith by reason only of his knowing that an act is beyond the powers of the directors under the company's constitution.

(3) The references above to limitations on the directors' powers under the company's constitution include limitations deriving—

(a) from a resolution of the company or of any class of shareholders, or

(b) from any agreement between the members of the company or of any class of shareholders.

(4) This section does not affect any right of a member of the company to bring proceedings to restrain the doing of an action that is beyond the powers of the directors.

But no such proceedings lie in respect of an act to be done in fulfilment of a legal obligation arising from a previous act of the company.

(5) This section does not affect any liability incurred by the directors, or any other person, by reason of the directors' exceeding their powers.

(6) (This section has effect subject to—

section 41 (transactions with directors or their associates), and

section 42 (companies that are charities).'

The approach of the courts to these sections and their predecessors has to some extent followed that of Browne-Wilkinson V-C in *TCB Ltd v Gray*[1] when he was considering the European Communities Act 1972, s 9 which contained the original form of the present provisions. He said:

> 'In approaching the construction of the section, it is in my judgment relevant to note that the manifest purpose of . . . the section is to enable people to deal with a company in good faith without being adversely affected by any limits on the company's capacity or its rules for internal management. Given good faith, a third party is able to deal with a company through its . . . directors . . . . I approach the construction of the subsection with a great reluctance to construe it in such a way as to reintroduce . . . any requirement that a third party acting in good faith must still investigate the regulating documents of a company.
>
> '[Section 40(2)(b)(ii)] expressly provide(s) that good faith is to be presumed: [section 40(2)(b)(i)] further provides that the person dealing with the company is not bound to inquire as to limitations on the powers of the directors. In my judgment, it is impossible to establish lack of "good faith" within the meaning of the subsection solely by alleging that inquiries ought to have been made which [s 40(2)(b)(i)] says need not be made.
>
> '. . . Any provision in the articles as to the manner in which the directors can act as agents for the company is a limitation on their power to bind the company and as such falls within [s 40(2)(b)(i)].'

The quotation is out of context but nevertheless shows that the courts will be reluctant to defeat the object of the legislation by reintroducing any need to investigate the regulating documents of a company. Reference, however, to the discussions of the somewhat circular nature of attempting to define a threshold of procedural or substantive irregularity for attracting the protection of s 40 contained in the judgments of the members of the Court of Appeal in *Smith v Henniker-Major & Co*[2] illustrates the difficulty this problem presents.

Section 39(1) expressly enacts that the validity of an act done by a company shall not be called into question on the ground of lack of capacity by reason of anything in the company's constitution. The previous reference to 'memorandum' required of course to be changed since any remaining provisions dealing with a company's objects are now deemed to form part of its articles of association. This, together with Companies Act 2006, s 31(1) which provides:

'31
(1) Unless a company's articles specifically restrict the objects of a company, its objects are unrestricted.'

means that questions of corporate capacity, formerly embodied by the ultra vires doctrine, are no longer an issue in relation to non-charitable companies incorporated under the Companies Acts.

Section 40(1) enacts that in favour of a person dealing with a company in good faith[3], the power of the directors to bind the company shall be deemed to be free of any limitation under the company's constitution. An important change has occurred here: whereas s 35(A)(1) of the 1985 Act referred to the 'board of directors', the new provision refers only to 'directors'. This means that a third party dealing in good faith can look to the protection afforded by s 40(1) not only in respect of actions of the board of directors but also in respect of actions of committees or even individual directors[4]. This reduces the need for a third party to seek to rely on agency principles such as ostensible authority to validate an action of an individual director of a body constituting less than the board itself. A 'director' in this context will include a de facto director, even although not properly appointed as a director[5]. It is however safer to assume that the statutory protection will not extend to acts carried out by a person held out as a director but who has never been appointed at all.

A distinction should be drawn here between 'actions' of an individual never appointed as a director and a 'document' signed on behalf of the company by such a person (purporting to be a director) in accordance with either s 74(1) of the Law of Property Act 1925 or s 44 of the Companies Act 2006. In relation to such a document, the complete absence of appointment of the signatory in question will not of itself disapply the statutory protections those sections afford to a 'purchaser' relying upon the document as binding the company.

Section 40(2)(b)(i) further exempts anyone dealing with a company from enquiring about any limitation on the powers of the directors to bind the company or authorise others to do so. Moreover, s 40(2)(b)(iii) states that for the purpose of that section, a person shall not be regarded as acting in bad faith by reason only that he knows an act is beyond the powers of the directors under the company's constitution. Once again, the reference to the broader formulation 'directors' rather than the former use of 'board of directors' should be noted in relation to s 40(2)(b)(i).

1 [1986] Ch 621, [1986] 1 All ER 587; affirmed on appeal [1987] Ch 458, [1988] 1 All ER 108, CA.
2 [2002] EWCA Civ 762, [2003] Ch 182.
3 As to the scope of 'good faith' in this context, Blackburne J in *Ford v Polymer Vision Ltd* [2009] EWHC 945 (Ch), [2009] 2 BCLC 160 considered that one should first look to see whether the directors were making improper use of their powers. If not, he considered that it would be impossible to see how it could be said that a person dealing with the company was not acting in good faith.
4 Although comments made *obiter* in an application for summary judgment in *Bass Jarrington Ltd v Royal Bank of Scotland plc*, (HC13C02505) (7 November 2014, unreported) indicate that the Chancery Division Master hearing the matter thought otherwise.
5 Companies Act 2006, s 250.

**2.8** The wording of the sections is so wide that banks strictly speaking need no longer call for the constitutional documents of companies with which they deal





(although it remains usual practice to do so) and it may be thought that they can materially relax the procedures previously adopted in taking security. Nevertheless, there are still limitations on the statutory protection which make it desirable for banks to continue to require certified extracts of the minutes authorising their security.

If the transaction which would normally only be within the authority of the directors acting as a board has not been authorised by the board of directors but solely by certain individual directors acting without the authority of the board, s 40 will not apply. A purchaser might still be able to rely on s 44(2) (para **2.4**) but it is questionable whether a bank taking a guarantee is a purchaser because whilst it may have given valuable consideration and have acted in good faith, it does not acquire an interest in property. It is strongly arguable that such a bank has purchased nothing and that therefore the section does not apply, in which case, the lender would be required to rely upon general agency principles relating to apparent authority in order to argue that the company was bound by the guarantee[1]. A bank taking a charge would, however, be a purchaser for the purpose of s 44(2). Banks still need to be satisfied that their security has been authorised by the board of directors or by persons duly authorised by the board.

The directors can only act at a duly convened board meeting with a quorum in attendance or as otherwise expressly provided for by the company's articles of association. The rule in *Royal British Bank v Turquand*[2] confers protection against internal irregularities but that rule does not protect third parties who had notice of the irregularity or who were put on enquiry if proper enquiry would have revealed the defect.

Previous assumptions that s 35A of the Companies Act 1985 would nevertheless require (subject of course to *Royal British Bank v Turquand*) there to have been an actual resolution of the board of directors need reconsideration following the broad interpretations given to the scope of that section by the Court of Appeal in *Smith v Henniker-Major & Co*[3]. In that case, a director's attempt to invoke the section to validate an inquorate resolution advantageous to himself was struck out. Carnwath LJ nevertheless gave an expansive interpretation to s 35A. Whilst not laying down a general test, he expressed the view, still relevant when considering actions of a company normally within the authority of the board, that[4]:

> 'The general policy seems to be that if a document is put forward as a decision of the board by someone appearing to act on behalf of the company in circumstances where there is no reason to doubt its authenticity, a person dealing with the company in good faith should be able to take it at face value.'

The new wording of s 40 does not confer on individual directors any greater authority than that which previously existed by virtue of their status. What s 40 does do however is to extend the protection previously afforded by ss 35A and 35B of the 1985 Act to actions by individual directors within the usual authority of persons holding that office irrespective of the fact that their authority may be further limited by the company's constitution, even where their appointment as a director may have been defective in some way.

Section 40 protects third parties dealing with a company in good faith from any limitation of a director's powers contained in a company's constitution. Such persons are not bound to enquire as to any limitation on the powers of

the directors (s 40(2)(b)(i)). They are presumed to be acting in good faith even if they do not enquire about limitations on the powers of the directors. Nevertheless, and despite s 40(2)(b)(iii), a person may still be found from other surrounding evidence not to be acting in good faith if he actually knows that the directors' powers are limited or if he shuts his eyes to the facts presented to him without making reasonable enquiry (paras **2.6** and **2.7**).

As it is the usual practice of bankers to call for a copy of the constitution of a company when opening an account for it and, indeed, current new client identification procedures developed as a result of anti-money laundering legislation generally require these to be produced, the bank may have actual notice of an irregularity in the composition of the board at the meeting and so be outside the protection of s 40 and *Turquand*. Section 40(2)(b)(i) negatives any duty to enquire about any limitation on the powers of the directors but not about matters such as the convening of the meeting or composition of the board. Comfort can be derived from *Gloucester County Bank v Rudry Merthyr Steam and House Coal Colliery Co*[5] (para **2.2**) provided the bank is acting in good faith (paras **2.6** and **2.7**). A certified extract from the minutes will assist.

1 Although some comfort may be drawn from the fact that it appears the test may be similar in either case: see the useful discussion of this point in J Porteous, 'Feeling the (Corporate) Benefit? A Chill Wind for Lenders?' (2015) 3 JIBFL 138 at 140.
2 (1856) 6 E & B 327.
3 [2002] EWCA Civ 762, [2003] Ch 182.
4 [2002] EWCA Civ 762 at [108], [2003] Ch 182 at 213.
5 [1895] 1 Ch 629, CA.

**2.9** Even if the security is authorised by a duly constituted quorate board of directors, the challenge to it may be based not on any lack of authority contained in the company's constitution or resolution of the shareholders or shareholders' agreement (all of which are protected by ss 39 and 40) but on breach of duty by the directors in failing to act in accordance with their duties to the company concerned. Section 40(5) expressly enacts that s 40 does not affect any liability incurred by the directors or any other person by reason of the directors exceeding their powers. If the directors are not acting in proper discharge of their duties to the company in creating a guarantee or security, the sections will not protect the bank against liability as constructive trustee if it has knowledge of the misfeasance (paras **6.23** to **6.29**). Section 40(2)(b)(i) by which a person shall not be regarded as acting in bad faith by reason only of knowing that an act is beyond the powers of the directors under the company's constitution does not negative liability as a constructive trustee in such circumstances.

**2.10** Section 40 protects third parties dealing with the company but not the directors who are themselves concerned in the breach of limitations under the company's constitution, as discussed in *Smith v Henniker-Major & Co*[1]. It should be noted, however, that each judge in that case came to a different view (or in one instance specifically refused to express a concluded view) as to the possibility that a director having an 'incidental' involvement in a decision may be considered to be a 'third party' for the purposes of attracting s 40 protection. There is now no equivalent of s 35(2) of the Companies Act 1985 which expressly enacted that a member of a company may bring proceedings to restrain the doing of an act beyond the company's capacity. This provision





was considered to be unnecessary since, to the extent that a company may still retain an objects clause in its constitution, the directors' powers are correspondingly limited and they are under a statutory duty to act in accordance with the company's constitution[2]. Section s 40(4) preserves the right of members to bring proceedings to restrain any act which is beyond the powers of the directors. The directors themselves are unlikely in all but very limited circumstances to be able to derive protection from s 40.

1 [2002] EWCA Civ 762, [2003] Ch 182.
2 Companies Act 2006, s 171(a).

**2.11** By virtue of the Companies Act 2006, s 41, a transaction is voidable at the instance of the company if the board of directors exceeded any limitation on their powers under the company's constitution and the parties to the transaction included a director of the company or its holding company or a person connected (as defined in s 252 of the 2006 Act) with such director. However, the section does not affect the operation of s 40 in relation to any third party not connected with a director save that the court is given a wide discretion to affirm or set aside the transaction on the application of the company or the third party (s 41(6)). An example of where the court may exercise this discretion to affirm a transaction would be where, in good faith, the transaction raised funds in which the company was of great need, the funds being raised on reasonable terms and without benefiting the director or connected person in question (*Re Torvale Group Ltd*[1]). The transaction ceases to be voidable if (a) restitution is no longer possible, or (b) the company is indemnified against loss, or (c) rights acquired bona fide for value and without *actual* notice of the directors exceeding their powers by a person not a party to the transaction would be prejudiced, or (d) the transaction is affirmed by the company in general meeting (s 41(4)).

1 [1999] 2 BCLC 605.

**2.12** Finally, by s 42 of the Companies Act 2006, ss 39 and 40 do not apply to the acts of a company which is a *charity* except in favour of a person who (a) does not know at the time the act is done that the company is a charity, or (b) gives full consideration in money or money's worth in relation to the act in question and does not know that the act is not permitted by the company's constitution or that it is beyond the powers of the directors.

Where those exceptions do not apply, it is important therefore to remember that a transaction entered into by a charitable company may be avoided on the ground that it is outside the company's objects. The same concern may also to apply to other forms of body corporate, such as those incorporated under their own statutes.

## SPECIMEN MINUTES

**2.13** The form of the minutes will depend on the circumstances of each particular case and on the provisions of the constitution of the company concerned, but the specimen minutes set out below may be helpful. They start by summarising the arrangements with the bank and, where a guarantee is being given, record why the board of directors considers this to be in the

Chapter 13

# GUARANTEES AND THIRD-PARTY CHARGES

**13.1** Guarantees and indemnities are a difficult branch of English law; largely developed in the nineteenth century and little changed since. The rules concerning guarantees apply equally to third-party charges. Banks still use the concept of guarantees rather than seeking an indemnity from the third party to see them paid if the principal debtor fails to do so, whatever the reason. The third party might not be prepared to make such a commitment, but it is rarely invited to do so, even if it owns the principal debtor.

**13.2** Both a guarantee and an indemnity must have all the attributes of a valid contract including intention to create a legal obligation and must either be by deed or supported by good consideration. Consideration will exist if the bank is continuing to meet cheques but can be a problem if the guarantee or indemnity is restricted to a particular facility which has been fully drawn. Past consideration is no consideration (*French v French*[1]), though an extension of the repayment date would be. If in doubt about consideration, the bank should take the guarantee or indemnity by deed.

Similarly, the offer of a guarantee can be withdrawn until it is accepted by the bank acting in reliance on it. The usual contractual rules of offer and acceptance apply (*Offord v Davies*[2]).

1 (1841) 2 Man & G 644.
2 (1862) 12 CBNS 748.

**13.3** By s 4 of the Statute of Frauds 1677, a guarantee must be in writing. The section enacts:

> 'No action shall be brought whereby to charge the defendant upon any special promise to answer for the debt, default, or miscarriage 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.'

The section remains in force[1] because it is clearly desirable that guarantees be in writing as is the invariable practice, but it can cause problems if the parties attempt an oral variation of a guarantee. The guarantee need only be signed by the guarantor. Where there is a written guarantee, objective extrinsic evidence is admissible to explain the terms used notwithstanding the Statute of Frauds (*Perrylease Ltd v Imecar AG*[2]). The section only applies to guarantees not to

indemnities which constitute primary obligations (for a recent detailed discussion of this distinction, see *Pitts v Jones*[3]).

An email message agreeing to give a guarantee sent by an employee of the proposed guarantor may constitute a sufficient memorandum or note for the purposes of the Statute of Frauds, as may a concluding email in a sequence of negotiations by email, that have included the terms of a guarantee (*Golden Ocean Group Ltd v Salgaocer Mining Industries PVT Ltd*[4]). The mere automatic inclusion on the message of the proposed guarantor's email address will not be sufficient to constitute the signature of that person in order to satisfy the requirements of s 4 (*J Pereira Fernandes SA v Mehta*[5]). As Flaux J said in *Lindsay v O'Loughnane*[6]:

> '. . . as *Contex v Wiseman*[7], the most recent case in which the section has been considered, demonstrates, the purpose and limits of the section should be clearly understood. As Waller LJ explained at para 16 of his judgment the section is concerned with proving by evidence the existence of a representation and not with excusing fraudulent behaviour.
>
> 'In a modern context, the section will clearly be satisfied if the representation is contained in an email, provided that the email includes a written indication of who is sending the email. It seems that it is not enough that the email comes from a person's email address without his having "signed" it in the sense of either including an electronic signature or concluding words such as "regards" accompanied by the typed name of the sender of the email: see the decision of HHJ Pelling QC (sitting as a High Court Judge) in *J Pereira Fernandes v Mehta* [2006] EWHC 813 (Ch), [2006] 2 All ER 891, [2006] 1 WLR 1543.'

In transactions within the Consumer Credit Acts 1974 and 2006, the bank must also comply with the formalities required by that legislation, in particular s 105 of the 1974 Act, and the multitude of regulations made under it, which are outside the scope of this book.

1 For one example, see *Elpis Maritime Co Ltd v Marti Chartering Co Inc* [1992] 1 AC 21, [1991] 3 All ER 758, HL in which a note signed by brokers was held to suffice. Note, however, that the requirements of s 4 no longer apply in relation to 'financial collateral arrangements' as defined in the Financial Collateral Arrangements (No 2) Regulations 2003 (SI 2003/3226), reg 4(1).
2 [1987] 2 All ER 373 at 381.
3 [2007] EWCA Civ 1301 at [21]–[38], [2008] QB 706 at 712–716.
4 [2011] EWHC 56 (Comm), [2011] 1 CLC 125 affd [2012] EWCA Civ 265, [2012] 3 All ER 842, [2012] 1 WLR 3674.
5 [2006] EWHC 813 (Ch), [2006] 2 All ER 891, [2006] 1 WLR 1543.
6 [2010] EWHC 529 (QB) at [94]–[95], [2012] BCC 153.
7 *Contex Drouzhba Ltd v Wiseman* [2007] EWCA Civ 1201, [2008] 1 BCLC 631, [2008] BCC 301.

**13.4** That the Statute of Frauds remains of great importance (but nevertheless can be overlooked!) was demonstrated by the proceedings in *Actionstrength Ltd v International Glass Engineering IN.GL.EN. SpA*[1] which reached the House of Lords in order to determine, as a point of law, whether the operation of s 4 of the Statute could be avoided by estoppel. The claimant provided labour to the defendant contractor who had contracted to build a factory for the second defendant, Saint-Gobain Glass UK Ltd. Payments to the claimant were late and a substantial sum became owing. The claimant complained to the second defendant who, according to the claimant, made an oral agreement that in consideration of the claimant not withdrawing its





labour the second defendant would try to persuade the first defendant to meet its payment obligations, failing which it would withhold sums from payments due to the first defendant and pay the claimant directly from those sums.

The underlying facts remained in dispute, but upon the second defendant's defence that any oral agreement as alleged would constitute a guarantee unenforceable by virtue of s 4 of the Statute, the claimant argued that the second defendant was estopped from relying on the Statute due to the claimant's detrimental reliance upon the second defendant's promise. The House of Lords held that reliance such as that shown by the claimant in this case was a normal part of guarantee and that, as such, there was nothing which could be relied upon by the claimant to give rise to an estoppel. As stated by Lord Walker[2]:

> 'But it would wholly frustrate the continued operation of section 4 in relation to contracts of guarantee if an oral promise were to be treated, without more, as somehow carrying in itself a representation that the promise would be treated as enforceable.
>
> 'To treat the very same facts as creating as an unenforceable oral contract and as amounting to a representation (enforceable as soon as relied on) that the contract would be enforceable, despite section 4 – and to do so while disavowing any reliance on the doctrine of part performance – would be to subvert the whole force of the section as it remains in operation, by Parliament's considered choice, in relation to contracts of guarantee.'

The House of Lords left open the possibility that an estoppel could arise in appropriate circumstances to prevent reliance upon s 4 of the Statute, with Lord Bingham expressly acknowledging that such a circumstance may arise[3]. The situations where this may arise would, however, be limited and may require, for example, the defendant to have expressly acknowledged to the claimant that it would not seek to rely upon the absence of writing[4].

1 [2003] UKHL 17, [2003] 2 AC 541.
2 [2003] UKHL 17 at [52]–[53], [2003] 2 AC 541 at 557, and see Lord Bingham's comments at [9] and 547.
3 [2003] UKHL 17 at [8], [2003] 2 AC 541 at 547, and see also, in a different context: *Seechurn v ACE Insurance SA-NV* [2002] EWCA Civ 67 at [21], [2002] 2 Lloyd's Rep 390 at 395.
4 See also the discussion in *Investec Bank (UK) Ltd v Zulman* [2009] EWHC 1590 (Comm) at [72], [2009] All ER (D) 156 (Jul), a point not requiring consideration in the subsequent appeal in that case ([2010] EWCA Civ 536, [2010] All ER (D) 167 (May)).

**13.5** An action for rectification of a written guarantee is similarly not precluded by s 4 of the Statute of Frauds where, due to a shared mistake, the signed guarantee did not correctly record the common intention of the parties (*GMAC Commercial Credit Development Ltd v Sandhu*[1]). The manner in which principles of construction will be applied to a guarantee will be the same as for other contracts with the exception of a genuine dispute about the existence of a guarantee agreement, where oral evidence will be examined with particular care (*Fairstate Ltd v General Enterprise & Management Ltd*[2]).

1 [2004] EWHC 716 (Comm), [2006] 1 All ER (Comm) 268.
2 [2010] EWHC 3072 (QB) at [75]–[76], 133 Con LR 112.

**13.6** In *Lakeman v Mountstephen*[1] the court had to decide whether the words 'I will see you paid' constituted a guarantee which, not being in writing, would

have been unenforceable under the above section. It was held that the words constituted an absolute contract involving a personal and primary liability. Lord Selborne said[2]:

> 'There can be no suretyship unless there be a principal debtor, who of course may be constituted in the course of the transaction by matters ex post facto, and need not be so at the time, but until there is a principal debtor there can be no suretyship. Nor can a man guarantee anybody else's debt unless there is a debt of some other person to be guaranteed.'

1 (1874) LR 7 HL 17.
2 (1874) LR 7 HL 17 at 24.

13.7 What bankers need is a clear undertaking that if they provide facilities to the customer, a third party of substance will see them paid. In such circumstances, the customer would be the principal debtor, and accordingly *Lakeman v Mountstephen*[1] (where the party originally intended to be the principal debtor did not commit itself) could be distinguished. Whether an obligation is a guarantee or constitutes a primary liability is a question of construction, but the court will base its decision on the substance of the transaction not the form. The mere use of the words 'principal debtor' will not alone be sufficient to constitute the instrument as an indemnity (*Credit Suisse v Allerdale Borough Council*[2]).

1 (1874) LR 7 HL 17.
2 [1995] 1 Lloyd's Rep 315 at 366–367, affirmed [1997] QB 306, CA.

13.8 The point was considered in *Heald v O'Connor*[1] where it was held that illegal assistance by a company in financing the purchase of its own shares could not be the subject of an enforceable guarantee. Fisher J said[2]:

> 'It seems to me that the only true distinction is one of construction. Did the guarantor undertake to pay only those sums which the principal debtor could lawfully be called on to pay but had not duly paid, or did he promise to pay those sums which the principal debtor had promised to pay but had not paid whether the principal debtor could lawfully be called on to pay them or not? I have no doubt that the promise made by the guarantor in the present case was the former. The promise was to pay the principal moneys which had become due under the debenture if the company did not. If the debenture was void then no moneys could become due under it. The decision in *Garrard v James*[3] seems to have been based on the view that the promise made by the guarantors in that case fell into the latter class.'

*Heald v O'Connor* is notable because the guarantee contained a provision that 'the liability of the guarantor shall be as a primary obligor and not merely as a surety'. The judge dismissed the clause as 'merely part of the common form provision'. The case may be contrasted with *General Produce Co v United Bank Ltd*[4] where a short guarantee contained a clause declaring: 'My/our liabilities hereunder shall be as that of principal debtor(s)'. It was held that the signatory was to be treated as principal debtor not from the inception of the document but in certain events. The plaintiff's liability under the document started life as that of a guarantor. But when T's liability was released it continued as that of a principal debtor[5].

There is no real conflict between the two cases. The documents before the court were very different in form, and it is hardly surprising that they received





a different construction. However, the concept of a document starting life as a guarantee but later becoming an indemnity is somewhat novel and an ingenious way of reconciling the inherent conflict in the document the court had to consider. Each case will turn on the construction of the particular document.

In *Coutts & Co v Browne-Lecky*[6] the guarantee remained a guarantee notwithstanding a sentence seeking to make the guarantor liable even if 'there is no principal debtor primarily liable'. Oliver J held[7]:

> 'In my opinion, the guarantors to a bank of an infant's loan, where all the parties know the facts, cannot be sued. It was further contended that, by reason of the last paragraph in the long printed document by means of which the bank indulge in these transactions, in the circumstances which have arisen, that document constituted a contract of indemnity and not of guarantee. If that were so there would be no answer to the action, because the defendants would be liable as principals.'

However, the contention that the document was an indemnity failed. The case should be contrasted with *Yeoman Credit Ltd v Latter*[8], where the third party remained liable for the infant because he had given an indemnity.

Under the Minors' Contracts Act 1987, s 2, a guarantee for liabilities incurred after the 9 June 1987 is no longer unenforceable merely because the principal debtor was a minor when he incurred the liability. The guarantee of such a liability incurred by a minor is now enforceable against the guarantor even though the principal debtor repudiates liability.

1 [1971] 2 All ER 1105, [1971] 1 WLR 497. Cf *Associated Japanese Bank (International) Ltd v Credit du Nord SA* [1989] 1 WLR 255 at 269.
2 [1971] 2 All ER 1105 at 1113.
3 [1925] Ch 616.
4 [1979] 2 Lloyd's Rep 255.
5 [1979] 2 Lloyd's Rep 255 at 258.
6 [1947] KB 104, [1946] 2 All ER 207.
7 [1947] KB 104 at 111.
8 [1961] 2 All ER 294, [1961] 1 WLR 828.

13.9 In *Garrard v James*[1] a company unlawfully agreed to purchase its own shares in certain events and the defendants joined in the arrangement and covenanted to accept liability for the due performance by the company of its obligations. Lawrence J held[2]:

> 'It is important to observe that the company committed no statutory offence by entering into the agreement and that the transaction was not malum in se. The only result was that the agreement could not be enforced against the company. The defendants, however, as an essential part of the transaction, jointly and severally covenanted with the plaintiff (1) to guarantee the full and proper performance by the company of the covenants on its part contained in the agreement, and (2) in the event of default being made by the company under its covenants, to accept liability and to guarantee the payments to the plaintiff in such manner, as if the covenants contained in clause 4 of the agreement had been repeated in the covenants with the defendants. In my opinion, the true meaning of the covenant on the part of the defendants is that, if the company does not perform its obligations under the agreement, the defendants will themselves perform those obligations.'

The case is sometimes treated as authority for the anomalous proposition that if directors guarantee ultra vires liabilities of their company, they will be liable even if the company is not. They might, of course, be liable for misrepresen-

tation or misfeasance but it is submitted that only an indemnifier remains liable once the principal debtor has ceased to be. Lawrence J construed the covenant as in substance an indemnity, as may very well have been the intention of the parties.

1 [1925] Ch 616.
2 [1925] Ch 616 at 622.

13.10 The more recent authorities evince a willingness to adopt a more sympathetic approach to the question of construction whether a document is a guarantee or an indemnity. The point was considered by the House of Lords in *Moschi v Lep Air Services Ltd*[1]. Lord Reid said[2]:

> 'I would not proceed by saying this is a contract of guarantee and there is a general rule applicable to all guarantees. Parties are free to make any agreement they like and we must I think determine just what this agreement means. With regard to making good to the creditor payments of instalments by the principal debtor 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. That would be a conditional agreement . . . If for any reason the debtor ceased to have an obligation to pay the instalment on the due date then he could not fail to pay it on that date. The condition attached to the undertaking would never be purified and 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. Then 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 he also puts the guarantor in breach of his contract of guarantee.'

A similar point was made by Lord Diplock where he said[3]:

> 'Whether any particular contractual promise is to be classified as a guarantee so as to attract all or any of the legal consequences to which I have referred depends upon the words in which the parties have expressed the promise. Even the use of the word "guarantee" is not in itself conclusive. It is often used loosely in commercial dealings to mean an ordinary warranty. It is sometimes used to mis-describe what is in law a contract of indemnity and not of guarantee. Where the contractual promise can be correctly classified as a guarantee it is open to the parties expressly to exclude or vary any of their mutual rights or obligations which would otherwise result from its being classifiable as a guarantee. Every case must depend upon the construction of the actual words in which the promise is expressed.'

It is submitted that if a document is described as a 'guarantee' the court will approach it on the assumption that it is simply a guarantee (as opposed to an indemnity) and the onus will be on the bank to rebut this presumption by pointing to clear words showing that the obligation was in fact to indemnify. However, the word 'guarantee' is not in itself conclusive of the issue. The recommended course is not to mis-describe the document but to include the word 'indemnity' in its title so that all concerned can readily appreciate the nature of the contractual obligation (see Part IV).

The importance of ensuring that the true intent of a document is clear on its face was highlighted in *Marubeni Hong Kong & South China Ltd v Mongolian Government*[4] in which a letter issued by the Mongolian Government was held to constitute a guarantee rather than an indemnity despite the fact that the word 'guarantee' did not appear in the operative provisions of the letter. The consequence was that variations of the underlying agreement detrimental to the principal debtor, such as waivers of possible causes of action against the





beneficiary of the Mongolian Government's letter, made without the consent or knowledge of the Mongolian Government, were held to have discharged the Mongolian Government from liability under the letter. The characterisation of a guarantee or similar obligation will have significant consequences for the type of liability that arises. As Patten LJ held in *McGuinness v Norwich and Peterborough Building Society*[5]:

> 'It is common ground that a guarantee of a loan may impose one or more of the following types of liability on the guarantor. These are:
> (1) a "see to it" obligation: i.e. an undertaking by the guarantor that the principal debtor will perform his own contract with the creditor;
> (2) a conditional payment obligation: i.e. a promise by the guarantor to pay the instalments of principal and interest which fall due if the principal debtor fails to make those payments;
> (3) an indemnity; and
> (4) a concurrent liability with the debtor for what is due under the contract of loan.
>
> 'The obligations in classes (2) and (4) create a liability in debt. But it is well established that an indemnity is enforceable by way of action for unliquidated damages: see *Firma C-Trade SA v Newcastle Protection and Indemnity Association* [1991] 2 AC 1 at pages 33–36. The liability arises from the failure of the indemnifier to prevent the person indemnified from suffering the type of loss specified in the contract. A guarantee of the "see to it" type has also been held by the House of Lords to create a liability in damages. The obligation undertaken by the guarantor is not one to pay the debt but consists of a promise that the debt will be paid by the principal debtor: see *Moschi v Lep Air Services Ltd* [1973] AC 331.'

1 [1973] AC 331, [1972] 2 All ER 393, HL.
2 [1973] AC 331 at 344–345, [1972] 2 All ER 393 at 398, HL. See also *Norwich and Peterborough Building Society v McGuinness* [2011] EWCA Civ 1286, [2012] 2 All ER (Comm) 265, [2012] 2 BCLC 233.
3 [1973] AC 331 at 349, [1972] 2 All ER 393 at 402, HL.
4 [2005] EWCA Civ 395, [2005] 2 All ER (Comm) 289, [2005] 1 WLR 2497.
5 [2011] EWCA Civ 1286 at [7]–[8], [2012] 2 All ER (Comm) 265 at 270.

13.11 Even if an indemnity is given, the creditor will still be presumed to owe a duty not to prejudice the indemnifier unless this duty is expressly negated in clear terms. Given the need to make banking arrangements flexible, an indemnity should rebut the various legal presumptions referred to below.

In *Duncan, Fox & Co v North and South Wales Bank* Lord Selborne in dealing with an indemnity held[1]:

> 'It is, however, consistent with this that the person who, as between himself and another debtor, is in fact a surety (though the creditor is no party to that contract of suretyship), has, against that other debtor, the rights of a surety; and that the creditor, who receives notice of his claim to those rights, will not be at liberty to do anything to their prejudice, or to refuse (when all his own just claims are satisfied) to give effect to them.'

He continued[2]:

> 'It appears to me that these principles of Equity are not less applicable to cases . . . in which there is, strictly speaking, no contract of suretyship, but in which there is a primary and secondary liability of two persons for one and the same debt, by virtue of which, if it is paid by the person who is not primarily liable, he has a right to reimbursement or indemnity from the other . . . '

A third party who has given an indemnity will not be discharged merely because the customer is not liable, but the bank must still be careful not to prejudice the indemnifier.

1 (1880) 6 App Cas 1 at 12, HL.
2 (1880) 6 App Cas 1 at 13, HL.

**13.12** The practice of waiving the duties owed to a guarantor was blessed in *Perry v National Provincial Bank of England* where Cozens-Hardy MR said:

> 'It is important to distinguish clearly between the rights of a surety under an ordinary contract of suretyship not containing any special provisions and the rights of a surety where the instrument creating the suretyship contains certain special clauses. It is elementary law that in a simple case of principal and surety the surety is discharged if the creditor gives time to the principal or does certain other acts; and a fortiori, if the creditor releases the principal debtor, of course the surety is released too. There are a certain number of acts which will not release the surety if, when the act in question is done, there is a reservation of rights against the surety. A common instance of this is giving time. When you find in the instrument of suretyship itself a provision that the surety shall be liable notwithstanding certain acts being done by the creditor which would otherwise release him, these doctrines have no application at all. It is not then a simple contract of suretyship. It is true that in one sense it is a contract of suretyship, but it is a contract of suretyship containing special clauses which deliberately exclude certain rights which the surety would otherwise have had.'

In the case, the third-party charge gave the bank power 'to vary exchange or release any other securities held or to be held by the bank for or on account of the moneys thereby secured or any part thereof . . . and to compound with, give time for payment of, and accept compositions from and make any arrangements with the debtors or any of them'[2]. The court held that these were acts which the surety had contracted that the bank might do without affecting its rights under the instrument. It had been argued that there could be no suretyship after the release of the principal debtor. Cozens-Hardy MR said[3]:

> 'But I think the answer to that is that it is perfectly possible for a surety to contract with a creditor in the suretyship instrument that notwithstanding any composition, release or arrangement the surety shall remain liable although the principal does not.'

2 [1910] 1 Ch 464, CA.
3 [1910] 1 Ch 464 at 473, CA.

**13.13** The above case[1] has been a source of much comfort to banks, but the law has now become less settled.

In *Standard Chartered Bank Ltd v Walker* Lord Denning MR said[2]:

> 'But it seems to me that, if a clause in a guarantee makes the guarantor liable for a larger sum than the mortgagor, that clause is unenforceable. The guarantor has only a secondary obligation to guarantee the debt of the principal debtor. If the principal debtor's debt is reduced for good reason, equally the guarantor's obligation is reduced. If there is a term in the contract to the contrary, it should be rejected as being repugnant or unreasonable (see *Gillespie Bros & Co Ltd v Roy Bowles Transport Ltd*[3] and the cases cited therein[4]). But nowadays we do not have to look at those cases. The Unfair Contract Terms Act 1977 applies to this contract. The terms of a contract are only good insofar as they are fair and reasonable.'





However, in *Barclays Bank plc v Kingston*[5] it was accepted that sufficiently clear language in a guarantee can achieve precisely the result that Lord Denning considered to be repugnant (see also para **13.67** below).

1 [1910] 1 Ch 464, CA.
2 [1982] 3 All ER 938, [1982] 1 WLR 1410, CA.
3 [1973] QB 400, [1973] 1 All ER 193, CA.
4 [1973] QB 400 at 415–416, [1973] 1 All ER 193 at 200–201, CA.
5 [2006] EWHC 533 (QB) at [30], [2006] 1 All ER (Comm) 519 at 527.

**13.14** One approach is to spell out in the clearest terms what will and what will not release the guarantor, but many bankers, striving for simplicity and the commercial needs of a modern age, prefer short documents and omit unreasonable clauses. The best solution is to take an indemnity rather than a mere guarantee, but banking practice has yet to take this step.

## LEGAL PRESUMPTIONS CONCERNING GUARANTEES AND INDEMNITIES

**13.15** Subject to para **13.13**, the legal presumptions can be varied by the express terms of a guarantee or indemnity (*Perry v National Provincial Bank of England*[1]). Broadly, the overriding principle is that the creditor must not prejudice the rights of the surety either against the principal debtor or against co-sureties. The rights will depend on what liabilities are within the guarantee.

The same rights and duties which apply in relation to a guarantee or indemnity also apply to a third-party charge (*Bolton v Salmon*[2]). *Perry v National Provincial Bank of England*[3] was also a case concerning a third-party charge. If the third-party charge is intended to exclude any personal obligation to pay by the chargor, the covenant to pay formerly implied in the case of charges over registered land by the Land Registration Act 1925, s 28 must be expressly negatived in relation to such charges created prior to 13 October 2003 (see para **7.5**).

In the absence of agreement to the contrary, the following (see paras **13.16–13.48**) will release a surety.

1 [1910] 1 Ch 464, CA.
2 [1891] 2 Ch 48.
3 [1910] 1 Ch 464, CA.

### *(a)* The granting of time or indulgence

**13.16** In *Rouse v Bradford Banking Co Ltd*[1] Lord Herschell LC quoted with approval the earlier judgment of Lord Lyndhurst in *Oakeley v Pasheller*[2] where he had said:

> 'The principle of law is this, that where a creditor gives time to the principal, there being a surety, without any communication with the surety, and without the consent of the surety, it discharges him from liability because it places him in a new situation and exposes him to risk and contingencies which he would not otherwise be liable to.'

The rule was explained in *Polak v Everett* where Blackburn J held[3]:

> 'It has been established for a very long time . . . without a single case going to the contrary, that on the principles of equity a surety is discharged when the creditor, without his assent, gives time to the principal debtor, because by so doing he deprives the surety of part of the right he would have had from the mere fact of entering into the suretyship, namely, to use the name of the creditor to sue the principal debtor, and if this right be suspended for a day or an hour, not injuring the surety to the value of one farthing, and even positively benefiting him, nevertheless, by the principles of equity, it is established that this discharges the surety altogether.'

Quain J[4] quoted from Lord Loughborough in *Rees v Berrington*[5] where he said:

> 'It is the clearest and most evident equity not to carry on any transaction without the privity of him who must necessarily have a concern in every transaction with the principal debtor. You cannot keep him bound and transact his affairs (for they are as much his as your own) without consulting him. You must let him judge whether he will give that indulgence contrary to the nature of his engagement.'

The granting of time or indulgence is not necessarily beneficial to a surety, because the financial position of the principal debtor may deteriorate.

1 [1894] AC 586, HL.
2 (1836) 10 Bli NS 548, HL.
3 (1876) 1 QBD 669 at 673, CA.
4 (1876) 1 QBD 669 at 677, CA.
5 (1795) 2 Ves 540.

**13.17** The surety is only released if there is a binding agreement between the creditor and the principal debtor; not simply by delay. The surety can after all himself bring a quia timet action against the debtor if he finds the delay irksome. In *Clarke v Birley* North J held[1]:

> 'It is clear that, when the creditor enters into a binding contract with the principal debtor to give him time, without the assent of the sureties, and without reserving his remedy against the sureties, such giving of time discharges the sureties . . . But to produce this result, two things are necessary. There must be a binding contract to give time, capable of being enforced; and the contract must be with the principal debtor.'

1 (1889) 41 Ch D 422 at 433.

**13.18** What is more, the surety is not released even if the creditor delays in enforcing payment from the principal debtor to such an extent that the debt becomes statute barred. In *Carter v White* Lindley LJ said[1]:

> 'Is it the law that a creditor who neglects to sue his debtor till the statute (of limitations) has run will thereby discharge his surety? There is no decision to that effect. On the contrary, the true principle is that mere omission to sue does not discharge the surety, because the surety can himself set the law in operation against the debtor.'

Where, however, the creditor improperly realises its security at less than market value, the surety will be discharged to the extent of the loss he has suffered as a result (*Skipton Building Society v Stott*[2]).

1 (1883) 25 Ch D 666 at 672, CA.
2 [2001] QB 261, CA and see para **13.27**.





### *(b)* Variation of the contract

**13.19** If the liabilities of the principal debtor which the surety has guaranteed are varied, the surety is released unless he has agreed to the change or it is trivial or clearly beneficial to him.

In *Bolton v Salmon* Chitty J held[1]:

> 'The true rule . . . is that if there is any agreement between the principals with reference to the contract guaranteed, the surety ought to be consulted, and that if there is any alteration, which is not obviously unsubstantial or for the benefit of the surety, he is to be the sole judge whether he will remain liable. This reasoning applies with the same force to a security given by the surety as it does to a personal obligation entered into by him.'

1 [1891] 2 Ch 48 at 54.

**13.20** The rule against variation is just as applicable now as in the past, and is particularly relevant if loans are rescheduled (for example, in a rescue operation). Even if the guarantee purports to allow time or indulgence to be granted, it is questionable whether this allows the bank to make a fundamental variation to the facility and to involve the guarantor in the risks of a rescue operation unless he consents.

In *Burnes v Trade Credits Ltd*[1] the Privy Council held that an agreement to extend a facility but at an increased rate of interest was a material variation to the loan agreement and released the guarantor notwithstanding that the guarantee authorised the borrower to be granted 'time or any other indulgence or consideration'. It was held that the increase in the rate of interest went beyond anything contemplated by such clause.

Again, in *National Bank of Nigeria Ltd v Awolesi*[2] the Privy Council held that a guarantee of a particular account did not contemplate the opening of a second account, and that the opening of the second account was a substantial variation of the contract and discharged the guarantee. The case turned on the construction of the guarantee before the court. The court held[3]:

> 'The bank is now content to accept the lesser sum as representing an approximation of the amount which would be due if the various accounts had in truth been operated as one. They were not operated as one and the question is whether the respondent has been substantially prejudiced by the way in which the accounts were in fact operated. Their Lordships are of the opinion that by acting as it did, outside the terms of the guarantee, the bank increased the burden on the respondent as guarantor and that the respondent's guarantee was discharged whichever construction of the document is adopted.'

1 [1981] 2 All ER 122, [1981] 1 WLR 805, PC on appeal from the New South Wales Court of Appeal.
2 [1964] 1 WLR 1311, PC on appeal from the Federal Supreme Court of Nigeria.
3 [1964] 1 WLR 1311 at 1317, PC.

**13.21** However, a surety is not released by a variation which could only operate for his benefit. In *Holme v Brunskill* Cotton LJ explained the position in this way[1]:

Document 1

# DEBENTURE

The debenture set out below is created by a single company to secure all its liabilities to a bank, and should be compared with the composite debenture which secures the liabilities of a group of companies to a Bank. It will require modification according to the nature of the assets charged and/or if the intention is to secure only those obligations arising under a specified agreement. Words shown in square brackets are often omitted. Due to the difficulties in showing effective receipt or maintaining up to date email addresses and monitoring of mailboxes, email communications are often specifically excluded from the notice provisions of bank documents: the option to exclude or include such methods are provided for in this document.



This DEBENTURE is dated. . . . . 20 . . . and made BETWEEN:

(1) . . . . . LIMITED/plc (Registered No. . . . . )whose registered office is at. . . . . (the 'Company')and

(2) . . . . . LIMITED/plc (Registered No. . . . . ) whose registered office is at. . . . . ('the Bank')

IT IS AGREED as follows:

1. DEFINITIONS

1.01 In this Deed the following expressions shall unless the context otherwise requires bear the following meanings:

'Business Day' means a day (other than a Saturday or Sunday) on which banks are open for general business in [London];

'Charged Assets' means the goodwill undertaking property assets revenues and rights of the Company charged by this Deed;

'Default Rate' means interest at . . . per cent per annum over the base rate of the Bank from time to time or such other rate as may from time to time be agreed;

'Environmental Matters' means any pollution waste (as defined by the Environmental Protection Act 1990) emissions substance or activity perceived as capable of causing harm to man or any other living organism or of damaging the environment or public health and welfare or to the conservation or protection of the environment or relating to nuisance noise fire precautions defective premises or health and safety;

['Prior Charges' means the charges referred to in Schedule 3 to the extent therein mentioned;]

'Receiver' means a receiver or a receiver and manager appointed by the Bank over any part of the Charged Assets and, where such is permitted by law, includes an administrative receiver.

1.02 The expressions 'Company' and 'Bank' where the context admits include their respective successors and assigns whether immediate or derivative. Any appointment or removal of a receiver under Clause 9 (*Appointment and Powers of Administrator and Receiver*) and any consents hereunder may be made or given in writing signed or sealed by any such successors or assigns of the Bank and the Company hereby irrevocably appoints each successor and assign of the Bank to be its attorney in the terms and for the purposes set out in Clause 10 (*Power of Attorney*).

1.03 In this Deed:

(a) reference to Clauses Sub-clauses and Schedules are unless otherwise stated to Clauses Sub-clauses and Schedules to this Deed;

(b) any liability or power which may be exercised or any determination which may be made hereunder by the Bank may be exercised or made in its absolute and unfettered discretion and the Bank shall not be obliged to give reasons for such exercise;

(c) references to statutory provisions shall be construed as references to those provisions as respectively replaced amended or re-enacted from time to time and all secondary legislation made thereunder;

(d) the headings to the Clauses are for convenience only and have no legal effect;

(e) this Deed shall be enforceable notwithstanding any reconstruction reorganisation or change in the constitution of the Bank or its absorption in or amalgamation with or the acquisition of all or part of its undertaking by any other person.

2. COVENANT TO PAY

2.01 The Company hereby covenants that it will on demand pay to the Bank all moneys and discharge all obligations and liabilities whether actual or contingent now or hereafter due owing or incurred to the Bank by the Company in whatever currency denominated whether on any current or other account or otherwise in any manner whatsoever (whether alone or jointly as principal or surety and in whatever style name or form and whether originally owing to the Bank or acquired by it from any other person) [when the same are due] including all liabilities in connection with foreign exchange transactions, swap arrangements, issuing confirming accepting endorsing or discounting any notes or bills, or under bonds guarantees indemnities documentary or other credits or any instruments whatsoever from time to time entered into by the Bank for or at the request of the Company together with interest to date of payment at such rates and upon such terms as may from time to time be agreed and all commission fees and other charges and all legal and other costs and expenses incurred by the Bank in relation to the Company or the assets hereby charged on a full indemnity basis.

2.02 The Bank shall cease to be under any further commitment to the Company and all moneys obligations and liabilities hereby secured shall immediately become due and payable on demand and the Company shall





provide cash cover on demand for all contingent liabilities of the Company to the Bank and for all notes or bills accepted endorsed or discounted and all bonds guarantees indemnities documentary or other credits or any instruments whatsoever from time to time issued or entered into by the Bank for or at the request of the Company on the occurrence of any of the following events of default, namely:

(a) if the Company fails to pay on the due date any money or to discharge any obligation or liability payable by it from time to time to the Bank or fails to comply with any term condition covenant or provision of this Debenture or of any facility present or future from the Bank or to perform any obligation or liability of the Company to the Bank or if any representation warranty or undertaking from time to time made to the Bank by the Company is or becomes incorrect or misleading in a material respect;

(b) if the Company defaults under any trust deed loan agreement debenture or other agreement or obligation relating to borrowing (which expression includes all liabilities in respect of any type of credit and accepting endorsing or discounting any notes or bills [all unpaid rental and other liabilities present and future under hire-purchase credit sale conditional sale leasing and similar agreements the purchase price or charge for all acquisitions or services payment of which is deferred for three months or more] and all liabilities under debt purchase factoring and like agreements contingent on non-payment of any debt) or under any guarantee (which expression includes all contingent liabilities undertaken in respect of the obligations or liabilities of any third party including all guarantees indemnities or bonds whether constituting primary or secondary obligations or liabilities) or if any borrowing or other money payable under any of the foregoing becomes or is capable of being declared payable prior to its stated maturity or is not paid when due or if any debenture mortgage charge or other security now or hereafter created by the Company becomes enforceable or if any facility or commitment now or hereafter available to the Company is withdrawn or cancelled by reason of default;

(c) if a [bona fide] petition is presented or an order made or a resolution passed or analogous proceedings are taken for winding up or dissolving the Company or any step is taken for putting it into administration or obtaining a moratorium for the Company or if a notice is issued convening a meeting for the purpose of passing any such resolution or taking any such step (save for the purpose of and followed within four months by an amalgamation or reconstruction not involving or arising out of insolvency on terms previously approved in writing by the Bank) or to comply with s 656 of the Companies Act 2006 where applicable;

(d) if an encumbrancer takes possession or exercises or attempts to exercise any power of sale or a receiver is appointed of the whole or any part of the undertaking property assets or revenues of the Company;

(e) if any [final] judgment or order made against the Company is not complied with within seven days or if an execution distress sequestration or other process is levied or enforced upon or sued out against any part of the undertaking property assets or revenues of the Company;

(f) if the Company stops payment or agrees to declare a moratorium or becomes or is deemed to be insolvent or unable to pay its debts within the meaning of s 123 of the Insolvency Act 1986 or when they fall due or if a notice is issued convening a meeting of or the Company proposes or enters into any composition or arrangement with its creditors generally or any class of its creditors;

(g) if the Company without the prior consent in writing of the Bank ceases or threatens to cease to carry on its business or any material part thereof in the normal course or changes the nature or mode of conduct of its trading in any material respect;

(h) if any material part of the assets or revenues of the Company is sold or disposed of or threatened to be sold or disposed of (otherwise than in the normal course of trading as a going concern) whether in a single transaction or a number of transactions or is nationalised compulsorily acquired seized or appropriated [or if any partnership of which the Company is or becomes a partner is dissolved] or if any notice served upon the Company with a view to forfeiture pursuant to s 146 of the Law of Property Act 1925 is not complied with or if any commercial rent recovery action is commenced against the Company;

(i) if this Deed or any guarantee indemnity or other security for any money obligation or liability hereby secured fails or ceases in any respect to have full force and effect or to be continuing or is terminated or disputed or becomes in jeopardy invalid or unenforceable;

(j) if any licence authorisation consent or registration at any time necessary or desirable to enable the Company to comply with its obligations to the Bank or to carry on its business in the normal course shall be revoked withheld or materially modified or shall fail to be granted or perfected or shall cease to remain in full force and effect;

(k) if in any country in which the Company carries on business or has assets any event occurs which corresponds with or has an effect similar to any of the foregoing events or if the Company becomes subject to proceedings or an order appointment or filing under the insolvency laws of such country;

(l) if breach of any environmental law regulation directive or licence applicable to the Company its business or assets could reasonably be expected to have a material adverse effect on the financial condition of the Company [or any of its subsidiaries or on the value or marketability of any of the assets of the Company] or if the Bank becomes liable in respect of any Environmental Matters as hereinafter defined or subordinated to the claims or rights of any environmental agency.

(m) if control (as defined in s 435(10) of the Insolvency Act 1986) or the power to take control of the Company is acquired by any person or company or group of associates (as defined in such section) not having control of the Company at the date hereof (unless with the prior consent in writing of the Bank); or

(n) if:





(i) any of the foregoing events occurs without the prior consent in writing of the Bank in relation to (a) any third party which now or hereafter has guaranteed or provided security for or given an indemnity in respect of any money obligation or liability hereby secured or (b) any subsidiary or holding company (as defined by s 1159 of and Sch 6 to the Companies Act 2006) of the Company or of any such third party or any [material] subsidiary of any such holding company; or

(ii) any individual now or hereafter liable as such third party shall die or become of unsound mind or have a bankruptcy petition presented or an interim order or a bankruptcy order made against him.

2.03 The Company hereby covenants immediately to notify the Bank in writing of the occurrence of any of the events of default specified in Clause 2.02 or of the occurrence of any event which with the lapse of time or giving of notice would or may constitute any of the same.

3. INTEREST

3.01 The Company shall pay commission interest fees and charges to date of payment (as well after as before any demand or judgment or the liquidation or entry into administration of the Company) at the rates and upon the terms from time to time agreed with the Bank [or in the absence of agreement at . . . per cent per annum over the base rate of the Bank from time to time] upon such days as the Bank may from time to time determine and such interest shall be compounded in the event of it not being punctually paid with quarterly rests in accordance with the usual practice of the Bank but without prejudice to the right of the Bank to require payment of such interest when due.

4. CHARGING CLAUSE

4.01 The Company with full title guarantee [(but so that the operation of s 6(2) of the Law of Property (Miscellaneous Provisions) Act 1994 is excluded)] hereby charges to the Bank as a continuing security for the payment of all moneys and the discharge of all obligations and liabilities hereby covenanted to be paid or otherwise hereby secured:

(a) the freehold leasehold and common hold property of the Company both present and future including but not limited to the properties specified in Schedule 1 and all buildings and fixtures (including trade and tenants' fixtures) from time to time on any such property and all liens charges options agreements easements rights and interests over land or the proceeds of dispositions of land both present and future;

(b) all plant machinery vehicles computers and other equipment of the Company both present and future (including but not limited to those items specified in Schedule 2 and all spare parts replacements modifications and additions for the same) and the full benefit of all warranties and contracts relating to the same but excluding stock-in-trade of the Company and all such items ordinarily disposed of by the Company in the normal course of trading as a going concern;

(c) all stocks shares bonds and securities (including warrants and options in relation to the same) of any kind whatsoever whether

marketable or otherwise and all other interests including but not limited to loan capital of the Company both present and future in any company firm consortium or entity wherever situated including all allotments accretions offers rights benefits and advantages whatsoever at any time accruing offered or arising in respect of the same whether by way of conversion redemption bonus preference option dividend interest or otherwise (collectively, the 'Securities') but excluding any Securities being items ordinarily disposed of by the Company in the normal course of trading as a going concern;

(d) all book and other debts revenues and claims both present and future (including bank deposits, credit balances and rights under hedging agreements or derivative transactions entered into by the Company in connection with protection against or benefit from fluctuation in any rate or price) and all things in action due or owing or which may become due or owing to or purchased or otherwise acquired by the Company and the full benefit of all rights and remedies relating thereto guarantees indemnities debentures legal and equitable charges and other security reservation of proprietary rights rights of tracing liens and all other rights and remedies of whatsoever nature in respect of the same;

(e) the uncalled capital goodwill and all patents trade marks and service marks (whether registered or not) brand and trade names registered designs design rights copyrights computer programs systems tapes disks software and other rights (including internet domain names) inventions confidential information know-how and all other intellectual or intangible property or rights and all applications for the protection of any of the foregoing in any part of the world, and all licences agreements and ancillary and connected rights and benefits including all royalties fees and other income accruing or arising from the same both present and future of the Company;

(f) all present and future contracts or policies of insurance (including life policies) in which the Company now or hereafter has an interest and all rights claims and moneys from time to time payable thereunder including any refund of premiums;

(g) the undertaking and all other property assets and rights of the Company whatsoever and wherever located both present and future (including but not limited to the stock-in-trade of the Company and all other items ordinarily disposed of by the Company in the normal course of trading as a going concern) and the heritable property and the whole of the property assets and rights in Scotland which is or may be from time to time while this Deed is in force comprised in the property and undertaking of the Company and the Charged Assets set out in paragraphs (a) to (f) above (if and in so far as the charges thereon contained in this Deed shall for any reason be ineffective as fixed charges).

4.02 The charges hereby created shall [rank subject only to the Prior Charges referred to in Schedule 3 to the extent therein specified and shall]:

(a) as regards the Charged Assets set out in Clause 4.01(a), (b), (c), (e) and (f) be [first] fixed charges, to the extent capable in law of being so charged (and as regards all those parts of the freehold leasehold and common hold property now vested in the Company shall constitute a charge by way of legal mortgage thereon);





(b) as regards the Charged Assets set out in Clause 4.01(d) be a [first] fixed charge in so far as such Charged Assets are from time to time paid or agreed to be paid into a blocked account monitored [and controlled] by the Bank and a first floating charge (subject to clause 5.02) in so far as not within such fixed charge; and

(c) as to the Charged Assets set out in Clause 4.01(g) be a first floating charge (subject to Clause 5.02).

4.03 Paragraph 14 of Schedule B1 to the Insolvency Act 1986 shall apply to the floating charges created by this Deed to the intent that each such charge shall be a 'qualifying floating charge' within the meaning of that paragraph.

4.04 To the extent that any of the Charged Assets constitute financial collateral and the security created by this Deed constitutes a security financial collateral arrangement (as each such term is defined in the Financial Collateral Arrangements (No 2) Regulations 2003), the Bank shall have the right at any time after the guarantees and security hereby created become enforceable to appropriate all or any part of such Charged Assets in or towards satisfaction of the moneys obligations and liabilities hereby secured. The value of any such Charged Assets so appropriated shall, in the case of cash, be the amount standing to the credit of the relevant account together with any accrued but unpaid interest at the time of appropriation and, in the case of Securities, be the current market value as listed on a recognised exchange or index at the time of appropriation or, failing such, such amount as is otherwise determined by the Bank acting in a commercially reasonable manner.

4.05 Upon the security created by the Deed becoming enforceable all dividends and other distributions paid to or otherwise received by the Company in respect of any Securities shall be held by the Company on trust for the Bank and any and all voting and other rights and powers attaching to the Securities shall be held on trust for the Bank and be exercised solely in accordance with any directions given by the Bank.

4.06 The Company hereby applies to the Chief Land Registrar for the registration against the registered titles (if any) specified in Schedule 1 (and any unregistered properties subject to first registration at the date hereof) of the following restriction for the protection of the charge created by this Deed:

'Except under an Order of the Registrar no disposition charge or other security interest is to be registered or noted without the consent of the proprietor for the time being of Charge No. . . . . '

4.07 [The Prior Charges and any legal mortgages or other charges that may be executed pursuant thereto shall rank to the extent specified in Schedule 3 together with interest thereon and costs in priority to the charges hereby created as a continuing security for repayment of all moneys obligations and liabilities thereby secured whether now owing or hereafter from time to time advanced or payable whether on current account or otherwise and the priority of the Prior Charges and the said legal mortgages or other charges to the above extent shall not be affected by any fluctuations in the amount from time to time due or by the existence at any time of a credit balance on any current or other account.]

4.08 The Company hereby agrees that the Bank may at any time without notice after an event of default or in making demand notwithstanding any settlement of account or other matter whatsoever combine or consolidate

all or any of its then existing accounts including accounts in the name of the Bank or of the Company jointly with others (whether current deposit loan or of any other nature whatsoever whether subject to notice or not and whether in sterling or in any other currency) wherever situated and setoff or transfer any sum standing to the credit of any one or more such accounts in or towards satisfaction of any obligations or liabilities of the Company to the Bank whether such liabilities be present future actual contingent primary collateral several or joint. Where such combination set-off or transfer requires the conversion of one currency into another such conversion shall be calculated at the then prevailing spot rate of exchange of the Bank (as conclusively determined by the Bank) for purchasing the currency for which the Company is liable with the existing currency.

## 5. NEGATIVE PLEDGE AND CRYSTALLISATION OF FLOATING CHARGE

5.01 The Company hereby covenants that it will not without the prior consent in writing of the Bank:

(a) sell assign discount factor pledge charge release set off or otherwise dispose of the Charged Assets set out in Clause 4.01(d) or any part of them or deal with the same otherwise than in accordance with Clause 6.02(a);

(b) create or attempt to create or permit to subsist any mortgage debenture charge or pledge upon [seek or permit to increase the amount secured by the Prior Charge] or permit any lien or other encumbrance (save a lien arising by operation of law in the ordinary course of trading) to arise on or affect the Charged Assets or any part of them; or

(c) part with possession of or transfer sell lease or otherwise dispose of the Charged Assets or any part thereof or attempt or agree so to do (except in the case of assets charged by way of floating charge only which may be sold at market value in the usual course of trading as now conducted for the purpose of carrying on the Company's business as a going concern).

5.02 Notwithstanding anything herein contained, if the Company charges pledges or otherwise encumbers (whether by way of fixed or floating security) any of the assets charged by way of floating charge or takes any steps so to do without the prior consent in writing of the Bank or if any person levies or attempts to levy any distress execution sequestration or other process or to obtain an injunction against any of such assets, the charge hereby created over the assets the subject thereof shall automatically without notice operate as a fixed charge.

5.03 If the Bank receives notice of any subsequent mortgage charge assignment or other disposition affecting the Charged Assets or any part thereof or interest therein the Bank may open a new account for the Company; if the Bank does not open a new account then unless the Bank gives express written notice to the contrary to the Company it shall nevertheless be treated as if it had done so at the time when it received such notice and as from that time all payments made by or on behalf of the Company to the Bank shall be credited or be treated as having been credited to the new account and shall not operate to reduce the amount due from the Company to the Bank at the time when it received notice.

## 6. COVENANTS BY THE COMPANY





6.01 The Company hereby covenants with the Bank that during the continuance of this security the Company will and shall procure that each of its subsidiaries will at all times:

(a) conduct and carry on its business in a proper and efficient manner and not make any substantial alteration in the nature of or mode of conduct of that business and keep or cause to be kept proper books of account relating to such business;

(b) observe and perform all covenants and stipulations from time to time affecting its freehold leasehold commonhold or heritable property or the mode of user or enjoyment of the same and not without the prior consent in writing of the Bank enter into any onerous or restrictive obligations affecting any such property or make any structural or material alteration thereto or do or suffer to be done on any such property anything which is 'development' as defined in s 55 of the Town and Country Planning Act 1990 nor do or suffer or omit to be done any act matter or thing which would have a material adverse effect on the value or marketability of any such property;

(c) observe and perform all covenants and stipulations from time to time affecting its patents trade marks and service marks brand and trade names registered designs design rights copyrights computer programs systems software inventions and other intellectual or intangible property or rights and all applications for the protection of the same and any licence or ancillary or connected rights or benefits from time to time relating to the same and take all necessary action to register preserve maintain and renew when necessary or desirable all such property licences and rights and not permit the same to be abandoned or cancelled or to lapse;

(d) keep all buildings and erections and all plant machinery fixtures fittings vehicles computers and equipment and effects and every part thereof in good and substantial repair and in good working order and condition with recognisable identification markings and not pull down or remove or sell or otherwise dispose of any of the same without the prior consent in writing of the Bank except in the ordinary course of use repair maintenance or improvement. If the Company is at any time in default in complying with this covenant the Bank shall be entitled but not bound to repair and maintain the same and any sum so expended by the Bank shall be repayable by the Company to the Bank on demand together with interest at the Default Rate from the date of payment by the Bank;

(e) comply with all laws regulations directives and codes of practice relating to Environmental Matters applicable to the Company or its subsidiaries or their respective businesses or to the Charged Assets and with any licence or approval relating thereto and obtain and maintain in full force and effect all such licences and approvals as are necessary or desirable or obtained by prudent companies with similar assets or carrying on similar businesses and promptly on receipt provide the Bank with copies of all such licences and approvals and of any amendments thereto;

(f) promptly on becoming aware of the same notify the Bank of the following:

(i) any indication that any of the properties hereby charged is or might be identified as 'contaminated land' within the meaning of Part IIA of the Environmental Protection Act 1990;

(ii) any claim notice of violation prosecution official warning abatement or other order relating to Environmental Matters or requiring compliance with any environmental law regulation directive or code of practice or with any licence or approval relating to Environmental Matters which is pending or threatened against the Company or any of its subsidiaries or any of their respective officers in their capacity as such or against any of the Charged Assets or its occupier or of any requirement to make any investment or expenditure or to take or desist from taking action which might have a material adverse effect on the Company or any of its subsidiaries or on any of the Charged Assets;

(iii) the existence or recent existence of any Environmental Matters at any of the properties occupied by the Company or any of its subsidiaries which may give rise to any environmental liability and take or procure the taking of all necessary action to remedy or remove or prevent the incursion of such Environmental Matters in a manner that complies with all environmental laws regulations directives and codes of practice;

(iv) any facts or circumstances entitling any environmental licence or approval to be revoked suspended amended or not renewed where this might have a material adverse effect on the Company [or any of its subsidiaries or their respective businesses or any of the Charged Assets] and of any requirement to make any investment or expenditure or to take or desist from taking any action where this might have a similar effect; and

(v) full details of any inspections investigations audits tests or other analyses concerning Environmental Matters relating to the Company or any of its subsidiaries or to any of the Charged Assets.

(g) at its own expense insure and keep insured all its property and effects whatsoever of an insurable nature with insurers previously approved by the Bank in writing against loss or damage by fire civil commotion explosion earthquake subsidence landslip heave aircraft and articles dropped therefrom flood storm lightning burst pipes theft malicious damage impact and such other risks and contingencies as the Bank shall from time to time request to the full replacement value thereof from time to time including architects, surveyors, engineers and all other professional fees and demolition charges together with full provision for estimated inflation and loss of rent for three years in the name of the Company with the interest of the Bank noted on the policy and with the policy containing such provisions for the protection of the Bank as the Bank may reasonably require to avoid the interest of the Bank being prejudiced by any act of the Company or of any occupier and maintain such other insurance policies (with the interest of the Bank noted thereon) containing like provisions for the protection of the Bank





as are normally maintained by prudent companies carrying on similar businesses and duly pay all premiums and other moneys necessary for effecting and keeping up such insurances and on demand produce to the Bank the policies of such insurance and proof of such payments failing which the Bank may take out or renew such insurances in any sum which the Bank may think expedient and all money expended by the Bank under this provision shall be reimbursed by the Company on demand and bear interest at the Default Rate from the date of payment by the Bank. [Subject to the Prior Charge] All moneys to be received by virtue of any insurance maintained or effected by the Company (other than in respect of employer's or public liability) shall be paid to the Bank (or if not paid by the insurers directly to the Bank held on trust for the Bank) and shall at the option of the Bank be applied in replacing restoring or reinstating the property or assets destroyed damaged or lost (any deficiency being made good by the Company) or (save in the case of leasehold premises) in reduction of the moneys obligations and liabilities hereby secured;

(h) punctually pay and indemnify the Bank and any administrator or receiver appointed by it against all existing and future rent rates taxes duties charges assessments impositions and outgoings whatsoever (whether imposed by agreement statute or otherwise and whether in the nature of capital or revenue and even if wholly novel) now or at any time during the continuance of this security payable in respect of the Charged Assets or any part thereof or by the owner or occupier thereof. If any such sums shall be paid by the Bank or by any such receiver the same shall be repaid by the Company on demand with interest at the Default Rate;

(i) not (without the prior consent in writing of the Bank) vary surrender cancel assign charge or otherwise dispose of or permit to be forfeited or repossessed its leasehold interest in any premises or any credit sale hire purchase leasing rental licence or like agreement for any material equipment used in its business [or agree any rent review] but shall generally fulfil its obligations under every such lease and agreement and when required produce to the Bank proof of all payments from time to time due from the Company thereunder;

(j) not (without the prior consent in writing of the Bank) form or acquire any subsidiary or transfer sell lease or dispose of any Charged Assets to any connected person (as defined by s 249 of the Insolvency Act 1986) save on terms previously approved in writing by the Bank;

(k) not do or cause or permit to be done anything which may in any way depreciate jeopardise or otherwise prejudice the value to the Bank or marketability of the security hereby charged and not (without the prior consent in writing of the Bank) incur any expenditure or liabilities of an exceptional or unusual nature.

6.02 The Company hereby further covenants with the Bank that during the continuance of this security the Company will:

(a) collect and realise all book and other debts revenues and claims hereby charged and pay all moneys which it may receive in respect thereof forthwith on receipt into such account as the Bank shall from time to time direct or failing any such direction into

the Company's account with the Bank and pending such payment hold such moneys on trust for the Bank and not (without the prior consent in writing of the Bank) charge or otherwise dispose of or otherwise deal with all or any of the same or purport so to do;

(b) [furnish to the Bank copies of the profit and loss account balance sheet and Directors' Report in respect of each financial year of the Company its holding companies and such of the subsidiaries of the Company or its holding companies as the Bank may from time to time require showing a true and fair view of their respective affairs profit or loss and source and application of funds certified by duly qualified auditors approved by the Bank forthwith upon the same becoming available and not in any event later than the expiration of four months from the end of such financial year and also at the time of issue copies of all statements and circulars to shareholders or to any class of creditors and from time to time such other information statements forecasts and projections of the Company its holding companies and the subsidiaries of the Company or its holding companies as the Bank may require;]

(c) not (without the prior consent in writing of the Bank) permit any person:

(i) to be registered as proprietor under the Land Registration Act 2002 of any freehold leasehold or commonhold property present or future from time to time hereby charged or any part thereof nor create or permit to arise any overriding interest as therein defined affecting such property or establish a commonhold association in respect of it; or

(ii) to become entitled to any proprietary right or interest which might affect the value or marketability of any land fixtures or fixed plant and machinery hereby charged;

(d) not (without the prior consent in writing of the Bank) redeem or purchase its own shares nor pay an abnormal amount by way of dividend;

(e) to inform the Bank immediately on contracting to purchase any estate or interest in any freehold leasehold commonhold or heritable property or to acquire stocks shares bonds securities or other interests in any company firm consortium or other entity and to supply the Bank with such details of such purchase or acquisition as the Bank may from time to time require;

(f) [subject to the Prior Charges] deposit with the Bank and permit the Bank during the continuance of this security to hold and retain the following:

(i) all deeds and documents of title relating to all freehold leasehold commonhold and heritable property from time to time belonging to the Company (and the insurance policies relating thereto);

(ii) all stock and share certificates and documents of title relating to the Securities and such deeds of transfer in blank and other documents as the Bank may from time to time require for perfecting its title to the Securities (duly executed by or signed on behalf of the registered holder) or for vesting





or enabling it to vest the same in itself or its nominees or in any purchaser;

(iii) all assurance policies from time to time effected by the Company on the lives of key officers and employees; and

(iv) all such documents relating to the Charged Assets as the Bank may from time to time require;

(g) [if required by the Bank procure that each (wholly owned) subsidiary of the Company shall guarantee to the Bank payment of all moneys obligations and liabilities hereby covenanted to be paid and charge all its undertaking property and assets to secure the same in such manner as the Bank shall from time to time require.]

6.03 The Company acknowledges that:

(a) the Bank its agents and their respective employees shall have power at reasonable times at the expense of the Company to enter on and inspect any of the Charged Assets for compliance with the covenants contained in this Deed and to remedy any breach; and

(b) on the occurrence of any of the events of default specified in Clause 2.02 the Bank shall be entitled at the expense of the Company to institute an investigation into and obtain a report from accountants lawyers and/or valuers of the Bank's choosing on the business affairs and financial position of the Company and its subsidiaries.

## 7 FURTHER ASSURANCE

7.01 The Company shall at any time if and when required by the Bank execute such further legal or other mortgages fixed or floating charges or assignments in favour of the Bank as the Bank shall from time to time require over all or any of the Charged Assets both present and future including but not limited to assets specified in any notice converting a floating charge into a fixed charge, all freehold leasehold commonhold and heritable properties present and future, the Securities and an assignment to the Bank of such of the book and other debts revenues and claims of the Company as the Bank shall from time to time require and all rights and remedies relating thereto both present and future (including any vendor's lien) to secure all moneys obligations and liabilities hereby covenanted to be paid or otherwise hereby secured or to facilitate the realisation of the Charged Assets or the exercise of the powers conferred on the Bank or an administrator or a receiver appointed by it, such further mortgages charges or assignments to be prepared by or on behalf of the Bank at the cost of the Company and to contain an immediate power of sale without notice a clause excluding s 93 and the restrictions contained in s 103 of the Law of Property Act 1925 and such other clauses for the benefit of the Bank as the Bank may reasonably require.

## 8. POWERS OF THE BANK

8.01 At any time after the Bank shall have demanded payment of any money hereby secured or any step is taken by the Company or any other person to appoint an administrator, liquidator, provisional liquidator, receiver or similar officer of the Company or any of its subsidiaries or of any of their respective assets or if so requested by the Company, the Bank may appoint an administrator of the Company or a receiver of all or part of the Charged Assets to the extent permitted by law or (without so appointing) may exercise without further notice and without the restrictions contained in ss 103 and 109 of the Law of Property Act 1925 all the powers

conferred on mortgagees by that Act as varied or extended by this Deed, all the powers conferred on the holder of a qualifying floating charge by the Insolvency Act 1986 and all other the rights powers and discretions conferred by this Deed on a receiver appointed hereunder.

8.02 Section 93 of the Law of Property Act 1925 shall not apply to this security or to any security given to the Bank pursuant hereto.

8.03 The statutory powers of leasing conferred on the Bank shall be extended so as to authorise the Bank in its own name or that of the Company to lease and make agreements for leases at a premium or otherwise and accept surrenders of leases and grant options on such terms and conditions as the Bank shall consider expedient and without the need to observe any of the provisions of ss 99 and 100 of the Law of Property Act 1925.

8.04 Any sale or other disposition by the Bank or by any of its nominees or by a receiver may be made either subject to or discharged from any prior mortgage charge or encumbrance or upon such terms as to indemnity as the Bank or such receiver may think fit and the Bank or the receiver may settle and pass the accounts of any person in whom such prior mortgage charge or encumbrance may from time to time be vested and any accounts so settled and passed shall as between the Bank the receiver and the Company be deemed to be properly settled and passed and shall be binding on the Company accordingly.

8.05 If the persons entitled to the benefit of any prior mortgage charge or encumbrance shall call in the money thereby secured or shall take any step to enforce the same the Bank may thereupon pay off those concerned and take a transfer of the benefit thereof or redeem the same and the money so expended by the Bank and all costs of and incidental to the transaction incurred by the Bank shall be added to the moneys obligations and liabilities hereby secured and bear interest at the Default Rate.

9. APPOINTMENT AND POWERS OF ADMINISTRATOR AND RECEIVER

9.01 At any time after the powers of the Bank under this Deed become enforceable the Bank may in writing under its Common Seal or under the hand of any authorised officer of the Bank appoint any person to be a receiver of the Charged Assets or any part thereof to the extent permitted by law.

9.02 Any appointment of a receiver over part only of the Charged Assets will not preclude the Bank from subsequently appointing a receiver over any other part of the Charged Assets. Where more than one receiver is appointed, each may act independently of the others unless the appointment otherwise specifies.

9.03 The Bank may from time to time fix the remuneration of the administrator or any receiver and may (subject to obtaining any necessary Court order) remove any receiver from all or any of the assets over which he has been so appointed and appoint another in his place.

9.04 An administrator or a receiver so appointed shall have no authority to act as agent of the Bank but shall be the agent of the Company and the Company shall be solely responsible for his acts or defaults and for his remuneration.

9.05 An administrator (in addition to the powers conferred pursuant to Sch B1 to the Insolvency Act 1986) and a receiver appointed hereunder shall have all the powers conferred from time to time on receivers by statute (in the case of the powers conferred by the Law of Property Act 1925 without the





restrictions contained in s 103 of the Act and so that powers set out in Sch 1 to the Insolvency Act 1986 shall extend to all receivers appointed hereunder whether or not they are administrative receivers).

9.06 Any receiver appointed by the Bank shall in addition have power on behalf and at the cost of the Company (notwithstanding liquidation of the Company) to do or omit to do anything which the Company could do or omit to do in relation to the Charged Assets which are the subject of the appointment or subject to enforcement by the Bank (the 'Relevant Assets') or any part thereof and in particular (but without limitation) any such receiver shall have power to:

(a) take possession of collect get in and give receipts binding on the Company for all or any of the Relevant Assets, exercise in respect of any contracts or the Securities comprised therein all voting or other powers or rights in such manner as he may think fit and bring defend or discontinue any proceedings or submit to arbitration in the name of the Company or otherwise as may seem expedient to him;

(b) carry on manage develop reconstruct amalgamate or diversify the business of the Company or any part thereof or concur in so doing, lease or otherwise acquire and develop properties or other assets without being responsible for loss or damage and raise or borrow any money (including money for the completion with or without modification of any building in the course of construction or renovation and any development or project in which the Company was engaged) from or incur any other liability to the Bank or others on such terms with or without security as he may think fit and so that any such security may be or include a charge on the whole or any part of the Relevant Assets ranking in priority to this security or otherwise;

(c) without the restrictions imposed by s 103 of the Law of Property Act 1925 or the need to observe any of the provisions of ss 99 and 100 of such Act sell by public auction or private contract, let vary the terms surrender or accept surrenders of leases or tenancies grant options or licences or otherwise dispose of or deal with all or any of the Relevant Assets or concur in so doing in such manner for such consideration and generally on such terms and conditions as he may think fit with full power to convey let surrender accept surrenders or otherwise transfer or deal with such Relevant Assets in the name and on behalf of the Company or otherwise. Any such sale lease or disposition may be for cash debentures or other obligations, shares stock securities or other valuable consideration and be payable immediately or by instalments and so that any consideration received or receivable shall ipso facto forthwith be and become charged with the payment of all moneys obligations and liabilities hereby secured. Plant machinery fixtures (including trade and tenants' fixtures) fittings and equipment may be severed and sold separately from the premises containing them and the receiver may apportion any rent and the performance of any obligations affecting the premises sold without the consent of the Company;

(d) promote the formation of companies with a view to the same purchasing leasing licensing or otherwise acquiring interests in all or any of the Relevant Assets or otherwise arrange for such