ASPECTS OF GUARANTEE CLAUSES AND THEIR DRAFTING

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1. This talk will focus on key clauses regularly found in modern guarantee forms, and the way in which they have been interpreted by the courts in recent cases. In this paper we consider first the general approach taken by the courts when interpreting guarantees, then the following specific provisions:

    a. clauses defining the scope of the guaranteed liabilities
    b. consideration clauses
    c. demand clauses
    d. principal debtor clauses
    e. conclusive evidence clauses
    f. clauses excluding the guarantor's rights
    g. continuing security clauses, and
    h. termination clauses.

Interpretation

2. The normal rules of contractual construction apply to written guarantees.[1] Applying those principles,[2] the court will ask "what meaning would it convey to a reasonable person having all the background knowledge which would reasonably have been available to the parties at the time of the contract"?[3]

3. The fact that the guarantee appears to have a clear meaning on its face does not prevent, or excuse, the court from looking at the background.[4] So although a guarantee expressed to apply to "the price of all trade goods that you may supply" would in its literal meaning only apply to goods supplied after the guarantee was given, having regard to the admissible background, the court construed the guarantee as covering both the existing and further debt of the principal debtor.[5]

4. However, the admissible background excludes evidence of the previous negotiations of the parties and their declarations of subjective intent.[6] So although a guarantor had discussions with the creditor some two years before giving the guarantee in which he had said he would not be personally liable for certain debts of the debtor, since those discussions were simply negotiations and did not give rise to a contractual agreement, they were not admissible in construing the scope of the guarantee.[7]

Clauses defining the scope of the guaranteed liabilities

5. Careful consideration needs to be given to the wording used in the clause defining the scope of the liabilities covered by the guarantee. Problems frequently arise when the clause is not drafted in sufficiently wide terms or with sufficient clarity to cover a particular liability.

6. The dangers of defining the scope of the guarantee by reference to a particular facility or agreement are exemplified by ***Triodos Bank NV v Dobbs***.[8] There the guarantee was expressed to cover payment of monies "under or pursuant to" two specific loan agreements (First Loan Agreements). The First Loan Agreements were rescheduled by two later loan agreements, and later again by a Third Loan Agreement which both rescheduled the debt and

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[1] *Egan v Static Control Components (Europe) Ltd* [2004] 2 Lloyd's Rep 429, CA at para 13.
[2] As to which see *Investors Compensation Scheme Ltd v West Bromwich Building Society* [1998] 1 WLR 896, HL at 912; and *Chartbrook Ltd v Persimmon Homes Ltd* [2009] 3 WLR 267.
[3] *Egan v Static Control*, above at para 15.
[4] *Egan v Static Control* at para 27.
[5] *Egan v Static Control* at para 17 and 36.
[6] ICS at 912, Chartbrook at para 4, 42, 69, 97 and 101.
[7] *ING Lease (UK) Ltd v Harwood* [2007] EWHC 2292 (QB) at para 72; upheld on appeal [2008] EWCA Civ 786.
[8] [2005] EWCA Civ 630.

increased the borrowing. The Bank argued that the guarantee covered the borrowing under the Third Loan Agreement because the guarantee provided that the Bank was entitled to "agree to any amendment, variation, waiver or release in respect of an obligation of the Company" under the First Loan Agreements. The Court of Appeal rejected that contention. It held that although the rescheduling under the Second Loan Agreements may still have fallen within the scope of the guarantee, the Third Loan Agreement had the effect of replacing, not merely amending or varying, the First Loan Agreements, such that the liability thereafter could not be said to arise under or pursuant to the First Loan Agreements, or to be within the "purview" of the First Loan Agreement.[9]

7. Similar issues arose recently in ***Investec Bank (UK) Ltd v Zulman***,[10] where the original guarantee contained a clause expressly limiting the liability to "the extent that the Debtor's liability to the Bank at the time of making demand by the Bank under this Guarantee exceeds £2,000,000 …". In fact the Debtor's borrowing had later been reduced to £1.5m, and the Bank had prepared a revised guarantee to provide that it should cover the reduced liability, but the revised guarantee had never in fact been signed. The Bank sought to argue that on its proper construction the original guarantee could be read as applying to the reduced liability, but that argument was rejected by David Steel J who held that the original terms were clear and unambiguous in covering only the excess over £2m. He also rejected a claim by the Bank to rectify the guarantee, on the basis that the Bank had fallen "well short of establishing proof (let alone convincing proof) that there was a mistake in the drafting process and that there had been a common intention at the time of the execution of the Guarantee that it would be enforceable regardless of the balance on the underlying loan".

8. Even if the scope of the liability has been defined in wide "all monies" terms, issues can arise if the parties to the guarantee did not in fact intend the guarantee to cover a particular type of liability. Two examples can be given.

9. First, in ***Barclays Bank v Caldwell***,[11] the bank wrote a side letter confirming that despite its "all monies" scope, the guarantee would apply only to the "top £70,000" of the debtor's overdraft facility, that it would not cover the debtor's loan account, that all receipts would go in reduction of the "top £70,000", that if the overdraft fell below £100,000 the guarantee was to be reduced to £50,000, and the guarantee would be discharged if the overdraft fell below £50,000. The guarantee was held to be unenforceable because it had been executed in terms which did not evidence this agreement and it did not therefore comply with the requirements of s 4 of the Statute of Frauds 1677 (that the terms of the guarantee should be evidenced contained in a note or memorandum signed by the guarantor).

10. The second example is ***ING Lease (UK) Limited v Harwood***,[12] where the guarantee provided as follows.

"In consideration of ING agreeing to make available facilities or other accommodation for so long as it may think fit to the Company the Guarantor hereby unconditionally and irrevocably guarantees to ING the due and punctual payment and discharge by the Company of ... all monies, obligations and liabilities whether actual or contingent now or hereafter due, owing or incurred to ING by the Company …"

11. Among the liabilities for which ING claimed under the guarantee were sums due to ING from the Company under certain hire agreements which had been assigned to ING by a third party after the guarantee had been entered into. The deputy judge (Michael Havery QC) held that on its proper construction the guarantee did not cover these liabilities, having regard to other terms of the guarantee and particularly a clause entitling the guarantor to give notice terminating "its

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[9] In Law of Guarantees 5th ed (2008) at p 148 Andrews & Millett caution against reading the judgment of Chadwick LJ in the Triodos case as laying down any general principle that any additional obligations imposed on the principal debtor by the varied agreement would be enough to make the variations fall outside the purview of the original agreement. At p 149 they suggest that in any substantial restructuring express agreement should be obtained from the guarantor that the old guarantee will extend to the new facilities, or a fresh guarantee should be executed.

[10] [2009] EWHC 1590 (Comm).

[11] Unreported, 25 July 1986 (Harman J).

[12] [2007] EWHC 2292 (QB); there was an appeal (see at [ ], but not on this issue).

liability in relation to Agreements made between the Company and ING". That wording was inappropriate to cover agreements made between the Company and third parties, but assigned to ING, and the parties could not have intended to allow the guarantor a right to give notice of termination in relation some only of the guaranteed liabilities and not others. Some further support for the same conclusion was to be found in the fact that the consideration was expressed in terms of ING (not third parties) making facilities available to the Company. The judge also took into account the fact that there was nothing in the background material to indicate that the parties contemplated assigned debts coming within the scope of the guarantee.

12. Sometimes these problems over the scope of the guarantee are overcome through the process of interpretation mentioned above.[13] Here are two further examples.

13. In ***Bank of Scotland v Wright***,[14] the guarantor was a director of two companies - "Holdings" and its subsidiary "Frozen Foods". The companies had an inter-available facility with the bank. The guarantee was expressed to cover "sums … due and to become due to you by your customer … in any manner or way whatever". The guarantor argued this was not apt, without clear words, to cover Holdings' contingent liabilities as surety for Frozen Foods' indebtedness to the bank. Brooke J rejected that contention having regard to the background to the giving of the guarantee, including the fact that the facilities which the bank was to give to Holdings included the granting of the inter-available facility to Holdings on which both Holdings and Frozen Foods could draw.

14. In ***Fliptex Ltd v Edney Enterprises Ltd***,[15] the creditor (Edney) agreed to take shares and loan stock in a company (East) for £1.5m. Under a shareholder's agreement, the debtor (Hardial) was required (by clause 24.4) to purchase the loan stock and shares if East defaulted in repaying the loan stock, and (by clause 24.1) to pay Edney £1.5m on demand if East went into liquidation. The guarantee (given by Fliptex) was expressed to cover all Hardial's liabilities under the shareholder's agreement with the creditor "in respect of the Loan Stock and the shares". The guarantor argued these words limited the guarantee to Hardial's liability under clause 24.4, so the guarantee did not cover Hardial's liability under clause 24.1 for failing to pay when East went into liquidation. Patten J rejected that contention. He held that the words of the guarantee were capable of applying in their ordinary meaning to Hardial's liability under clause 24.1 and that there was no commercial or other reason to have excluded the clause 24.1 liability from the scope of the guarantee, having regard to its other terms. He also rejected a submission that the guarantee should be construed against the party relying on it (contra proferentem) because he regarded that rule as one of last resort were there is genuine ambiguity. On the proper construction of the guarantee, there was no such ambiguity.

15. It may also be possible in a clear case to overcome any deficiency in the drafting of the clause defining the scope of the liability guaranteed by relying on the principles of estoppel by convention, if the parties can be shown to have reached and acted on a common understanding as to the scope of the guarantee. But although reliance on estoppel has been successful in at least one Court of Appeal decision where the identity of the guarantor was in doubt,[16] the dangers of having to resort to such principles to seek to overcome deficiencies in the drafting of guarantees are exemplified by the ING, Triodos and Investec cases, in which attempts to rely on estoppel failed. In the ING case the judge held that the guarantor failed to establish that he relied on an understanding when he signed the guarantee as to the scope of the liability guaranteed, and an appeal against this aspect of the judge's judgment failed.[17] In the Triodos case the guarantor denied having proceeded on the understanding that the Third Loan Agreement was still covered by the guarantee, and the Court of Appeal considered that gave rise to an issue fit for trial which was not susceptible to summary judgment. In Investec, David Steel J held that the evidence did not demonstrate that the guarantors had shared any assumption made by the Bank that the guarantee covered the principal debtor's liability even if less than £2m.

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[13] As it was in *Egan v Static Control* (above).
[14] [1990] BCC 663.
[15] [2002] EWHC 2844 (Ch).
[16] *Amalgamated Investment & Property Co Ltd v Texas Commerce International Bank Ltd* [1982] QB 84.
[17] [2008] EWCA Civ 786

Consideration clauses

16. Although there is no need for a guarantee to state the consideration for which it is given,[18] guarantees usually do so. As we have already seen from the ING case above, if the consideration for the guarantee is not stated in sufficiently wide terms so as to match the clause defining the scope of the liability guaranteed, the limitation on the way in which the consideration is defined may be taken into account as indicating that the scope of the guarantee was in fact intended to be more limited than might otherwise have been thought.

17. It has also been held that a departure from a term of the contract between the creditor and the principal debtor (so long as it is not obviously and without enquiry insubstantial) may discharge the guarantor from liability if the term has been "embodied" in the guarantee[19]. Since the statement of the consideration is likely to suffice to "embody" in the guarantee the facilities referred to as forming the consideration, care should again be taken to express the consideration accurately.

Demand clauses

18. Guarantees conventionally provide for the guarantor to pay on demand, whether or not the guarantor's liability is expressed to be as principal debtor/primary obligor. Regardless of the rule discussed below which may make it unnecessary to serve a demand, it is always best practice to serve a demand. The date of the demand will usually mark the date from which the applicable limitation period will run.[20] In addition, if (as usual) the guarantee provides for interest to be paid by the guarantor on sums for which he is liable under the guarantee, demand will fix the date from which interest will run.

Principal debtor clauses

19. Guarantees differ from indemnities in that under an indemnity the liability of the indemnifier is a primary liability, not dependent on prior liability being established against a third party, whereas the liability of a guarantor under a guarantee is secondary in the sense that the guarantor's liability arises if and when the principal debtor becomes liable to the creditor. Nevertheless, guarantees frequently include clauses which provide for the guarantor to be liable as if he were the principal debtor. It has been held that this does not convert what is in reality a guarantee into an indemnity, so in that particular case a principal debtor clause could not be relied on to make the guarantor liable when the principal debtor was not liable because the transaction between the principal debtor and the creditor was unenforceable on the grounds that it involved the giving of illegal financial assistance for the purchase of shares.[21]

20. What then is the utility of a principal debtor clause? First, the liability of a principal debtor can arise without the need for prior demand even if the contract requires payment on demand.[22] In ***MS Fashions Ltd v BCCI SA***,[23] where guarantees contained principal debtor clauses, it was held that the bank was entitled without prior demand to withdraw money from deposit accounts of the two guarantors (Mr Amir and Mr Ahmed) to apply against the debts of certain companies to BCCI. Dillon LJ stated[24] that the effect of the principal debtor clause was:

> "to dispense with any need for a demand in the case of Mr Amir since he has made the companies' debts to BCCI his own debts and thus immediately payable out of the

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[18] Mercantile Law Amendment Act, 1856, s 3.
[19] *National Westminster Bank plc v Riley* [1986] BCLC 268 (CA), referring to The Vavasseur Trust Co Ltd v Ashmore, Unreported, 2 April 1976.
[20] Even where there is strictly no need to make demand to crystallise the cause of action (under the principles discussed above), the effect of s 6 of the Limitation Act is that times usually runs from the date of demand: see for example, Boot v Boot [1996] 2 FCR 713 (CA).
[21] *Heald v O'Connor* [1971] 1 WLR 497; see to similar effect *Credit Suisse v Borough Council of Allerdale* [1995] 1 Lloyd's Rep 315 at 366 (Colman J).
[22] See *Re J Brown's Estate* [1893] 2 Ch 300.
[23] [1993] Ch 425.
[24] At 447.

deposit without demand. In the case of Mr Ahmed, there must be immediate liability even though the word "demand" was used, because he accepted liability as a principal debtor and his deposit can be appropriated without further notice".

21. See to the same effect ***T & S Global Ltd v Fithian-Franks***,[25] where David Richards J applied the reasoning of the BCCI case in refusing to set aside statutory demands served without prior demand on guarantors. The guarantees provided that:

> "the guarantors, as primary obligors, hereby irrevocably and unconditionally guarantee to the Beneficiary the due payment and discharge by the Company of such amount as is due and owing by the Company to the Beneficiary …"

22. The judge rejected an argument advanced by the guarantors that demand on them was made necessary by clause 2 of the guarantee which provided that on the Company defaulting they would pay on demand, without set-off.

23. Secondly, a principal debtor clause may keep the guarantor liable if events occur after the guarantee has been given which put an end to the liability of the principal debtor, or which might otherwise discharge the guarantor from liability.

24. For example, in ***National Westminster Bank plc v Riley***,[26] clause 1 of the guarantee provided:

> "… this Guarantee shall not be discharged nor shall the Guarantor's liability under it be affected by anything which would not have discharged or affected the Guarantor's liability if the Guarantor had been a principal debtor to the Bank instead of a guarantor."

25. The Court of Appeal held that this prevented the guarantor from being discharged even if there had been a departure from the terms of the contract between the creditor and the principal debtor such that the guarantor might otherwise have been discharged (on the basis of the principle to which we have referred above under the heading "Consideration").

26. Thirdly, if expressed in appropriate terms, a principal debtor clause may also indicate an intention on the part of the guarantor to undertake primary liability which is entirely independent of the liability of the principal debtor, and therefore arises irrespective of cross-claims which the principal debtor might be able to invoke against the creditor and which might otherwise be invoked by the guarantor to dispute liability under the guarantee. This aspect of principal debtor clauses often arises in association with conclusive evidence clauses, to which we now turn.

Conclusive evidence clauses

27. Guarantees often contain provisions that a certificate signed by an appropriate official of the creditor as to the amount of the principal debtor's liability, shall be conclusive evidence of the liability of the principal debtor. Such clauses not only seek to avoid problems which can arise in cases where it is difficult to prove the amount of the principal debtor's liability, but may be relied upon as indicating that what might at first blush appear to be a guarantee intended to impose only secondary liability (against which the guarantor may invoke defences available to the principal debtor) is in fact one giving rise to independent liability in the nature of a performance bond or first demand guarantee under which guarantor undertakes to pay irrespective of cross-claims which the principal debtor might have against the creditor. Whether the clause has that effect turns on the proper construction of the document as a whole. Here are two examples.

28. In ***Bache & Co (London) Ltd v Banque Vernes et Commercial de Paris SA***,[27] the Court of Appeal considered that a conclusive evidence clause was effective. The clause was contained in a guarantee issued by a French bank in favour of certain brokers, and provided that on notice

[25] [2007] EWHC 1401 (Ch).
[26] Above.
[27] [1973] 2 Lloyd's Rep 437.

of default being given by the brokers to the bank stating the amount of the liability, the bank would pay the amount stated and the notice would be conclusive evidence that the bank's liability had accrued under the guarantee in respect of the amount claimed in the notice.

29. Given recent criticisms of banks, the following extract from the judgment of Lord Denning MR[28] may sound surprising.

> "I would only add this: this commercial practice (of inserting conclusive evidence clauses) is only acceptable because the bankers or brokers who insert them are known to be honest and reliable men of business who are most unlikely to make a mistake. Their standing is so high that their word is to be trusted. So much so that a notice of default given by a bank or broker must be honoured. It ranks as equivalent to, if not higher than, the certificate of an arbitrator or engineer in a building contract. As we have repeatedly held, such a certificate must be honoured, leaving any cross-claims to be settled later by an arbitrator. So if a banker or broker gives a notice of default in pursuance of a conclusive evidence clause, the guarantor must honour it, leaving any cross claims by the customer to be adjusted in separate proceedings."

30. So in Bache, the effect of the conclusive evidence clause, read in context, was to prevent the guarantor from being able to invoke defences which might have been available to the principal debtor.

31. More recently, in ***IIG Capital LLC v Van Der Merwe***,[29] the Court of Appeal again had to consider a whether a guarantee was in fact intended to operate as a demand guarantee, such that the guarantors could not invoke defences available to the principal debtor. The guarantee included the following provisions.

> "In consideration of the Lender agreeing to enter into the Agreement, the Guarantor as principal obligor and not merely as surety unconditionally and irrevocably:
>
> 2.1 guarantees to the Lender the due and punctual payment of the Guaranteed Moneys and agrees that, if at any time or from time to time any of the Guaranteed Moneys are not paid in full on their due date … it will immediately upon demand unconditionally pay to the Lender the Guaranteed Moneys which have not been so paid
>
> 2.2 As an original and independent obligation under this Deed, the Guarantor shall
>
> 2.2.1 indemnify the Lender and keep the Lender indemnified against any loss … incurred by the Lender as a result of a failure by the Borrower to make due and punctual payment of any of the Guaranteed Monies …
>
> 3. … this Guarantee may be called and/or enforced without steps or proceedings first being taken against any other Obligor.
>
> 4.2 A certificate in writing signed by a duly authorised officer or officers of the Lender stating the amount at any particular time due and payable by the Guarantor under this Guarantee shall, save for manifest error, be conclusive and binding on the Guarantor for the purposes hereof."

32. Waller LJ (with whom Lawrence Collins and Rimer LJJ agreed) accepted[30] that there was a presumption against the guarantees being on demand bonds, but regarded the clauses of the guarantee as indicating that the guarantors were "taking on something more than a secondary obligation". He held that the conclusive evidence clause "puts the matter beyond doubt. Any presumption has by the language been clearly rebutted". The guarantors had agreed to pay on demand as primary obligors.

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[28] At 440 col 1.
[29] [2008] 2 Lloyd's Rep 187.
[30] At 194 col 1.

Clauses excluding the guarantor's rights

33. We have already referred to various principles of the law relating to guarantees which may cause the guarantor to be wholly discharged from liability in certain events – particularly if there has been some material variation in the principal debtor's obligation. The same result may occur if the creditor releases other security, or gives time to the principal debtor to pay or agrees to accept less than the debt due. Commonly, however, clauses are inserted into guarantees to prevent the guarantor from being discharged from liability in such circumstances.

34. In the IIG case, for example, the guarantee included the following plethora of clauses excluding the guarantor's rights.

> "3.1 The Lender shall be at liberty without thereby affecting its rights hereunder at any time at its absolute discretion and with or without the consent or knowledge of or notice to the Guarantor:
>
> 3.1.1 to give time to any Obligor for the payment of all or any sums due or payable under the Agreement or any other Finance Document;
>
> 3.1.2 to neglect or forbear to enforce payment of all or any sums due or payable under the Agreement or any other Finance Document and (without prejudice to the foregoing) to grant any indulgence or forbearance to and fail to assert or pursue or delay in asserting or pursuing any right or remedy against any Obligor thereunder;
>
> 3.1.3 to accept, vary, exchange, renew, abstain from perfecting, or release any other security now held or to be held by it for or on account of the Financial Indebtedness;
>
> 3.1.4 to amend, add to or vary the terms of the Finance Documents;
>
> 3.1.5 to compound with, accept compositions from and make any other arrangements with any other Obligor.
>
> 3.2 This Guarantee and the rights of the Lender hereunder shall not be affected by:
>
> 3.2.1 the appointment of a receiver, trustee or similar officer of any other Obligor, its undertaking or all or any of its or his asset.
>
> 3.2.2 Any alteration of the status of any other Obligor or any defective or irregular exercise of the powers of the Borrower to raise finance 3.2.3 The insolvency, bankruptcy, death, incapacity, winding up, liquidation or dissolution of any other Obligor;
>
> 3.2.3 Any failure by the Lender to take any other security for all or any part of the indebtedness agreed to be taken by the Lender pursuant to the Finance Documents or any total or partial invalidity, voidability or unenforceability of any such security;
>
> 3.2.4 The doing by the Lender of anything referred to in clause 3.1 above; or
>
> 3.2.5 Any other act or circumstance which (apart from this provision) would or might constitute a legal or equitable defence for or discharge of a surety or guarantor…"

35. The efficacy of such clauses in preserving in the liability of the guarantor does not seem to be in doubt. But they will usually be closely construed and need to be expressed in clear terms which cover the events which have happened if they are to be relied on by the creditor.[31]

36. So, for example, in ***Barclays Bank PLC v Kingston***,[32] a clause which allowed the Bank "to release, enforce or not enforce our rights under … any security" was held not apt to cover

[31] See for example per *Mann J in American Express International Banking Corp v Hurley* [1985] 3 All ER 564 at 571e.
[32] [2006] EWHC 533 (QB); see to similar effect *Lloyds TSB Bank plc v Shorney* [2001] EWCA Civ 1161 where the fact that the bank had failed to disclose to Mrs Shorney increases in the liability of the principal debtor, and this was held not to fall within the

circumstances in which the Bank had sold security at an undervalue in breach of its duty in equity to obtain a proper price.

37. For an example of a case in which a subsequent variation of a guarantee prevented the creditor from relying on a clause which would have prevented the guarantor from claiming to be discharged from liability, see ***Lloyds TSB Bank Plc v Hayward***.[33] In that case a side letter sent by the bank recording an agreement reached with the guarantor to give prior notice to the guarantor of any negotiation of payment terms which might affect him, was held to have varied the clauses in the guarantees on which the bank could otherwise have relied to prevent the guarantor from being discharged. Since the required notice had not been given to the guarantor, the guarantor was discharged from liability.

38. In his book Legal Problems of Credit and Security,[34] Professor Goode comments that the efficacy of clauses directed at preventing the surety from being discharged from liability may also be subject to the provisions of the Unfair Contract Terms Act 1977, if the clause is drafted in such a way that it can be construed as an exclusion or limitation clause,[35] although this is unlikely unless the clause actually excludes the liability of the creditor, rather than being expressed as giving the guarantor's consent to the events which might otherwise cause him to be discharged from liability. The more wide-ranging provisions of the Unfair Terms in Consumer Contracts Regulations[36] are more likely to apply, but only as regards a guarantee by a consumer, and only if the Regulations are held to apply to contracts of guarantee. Since Professor Goode's book was published, it has been held at first instance in ***Barclays Bank PLC v Kufner***,[37] that the Regulations would apply to a bank guarantee where the guarantor and the principal debtor had each entered into their respective contracts as natural persons and were not acting in the course of their trade or profession. Field J also expressed the view that even if it did not matter whether the principal debtor was acting in a business capacity, since the guarantor clearly had been he was not entitled to the protection of the Regulations.

Continuing security clauses

39. If a guarantee is not expressed to be a continuing security, it may be construed as covering only a specific transaction where the liability of the principal debtor may reduce (but is not intended to be increased once reduced) such as a guarantee for sums due under an HP agreement. The guarantor's liability will come to an end when the debtor has paid the instalments due. Where there is a facility under which the principal debtor's liability fluctuates because sums are credited and debited to an account from time to time (subject usually to a given limit), such as an overdraft facility on a current account, or sums advanced under a factoring or invoice discounting facility, provision must be made in the guarantee to ensure that the guarantor's liability does not come to an end when the balance of the account is repaid, or else sums which the principal debtor later draws down may not be covered. A continuing security clause achieves this by providing that the guarantee shall remain a continuing security for the principal debtor's obligations to the creditor at any time and that it shall not be satisfied or otherwise affected by any repayment from time to time of the whole or part of the sums due and owing by the principal debtor to the creditor.

40. In addition, in cases where the principal debtor's liability may fluctuate as outlined above, a well drafted guarantee will provide for the creditor to continue operating the principal debtor's account even after receipt of notice terminating the guarantor's liability under the guarantee. In the absence of such a provision the operation of the rule in Clayton's Case[38] might result in credits which are made to the account after the event of termination being treated as applied in

scope of a clause allowing the bank to "renew, vary, increase or determine any advances .." to the principal debtor, because the principal debtor's liabilities themselves arose under a guarantee and it was "outside the norm to expect that further guarantees would be given without notification to Mrs Shorney.

[33] [2005] EWCA Civ 466.
[34] Now 4th ed, 2008 at para 8-15.
[35] Some support for this view can be found in the judgment of Lord Denning MR in Standard Chartered *Bank v Walker* [1982] 1 WLR 1410 at 1416E.
[36] SI 1999/2083.
[37] [2008] EWHC 2319 (Comm).
[38] *Devaynes v Noble* (1816) 1 Mer 572, as applied in Deeley v Lloyds Bank Ltd [1912] AC 756 (HL).

reduction of the sum for which the guarantor would otherwise have been liable at the date of termination.[39]

Termination clauses

41. In the case of a continuing guarantee the guarantor has the right to terminate the guarantee, providing the consideration given for the guarantee is not entire but divisible. In the case of guarantees for running account balances, the consideration is usually regarded as divisible as to each advance; the guarantee comprising an offer to enter into each new advance which (on ordinary contract principles) can be revoked any time before the offer is accepted – acceptance by the creditor usually being by the creditor's conduct in making a new advance.[40]

42. It is not always easy to identify when the consideration for the giving of a guarantee is entire or divisible. It is likely to be entire (even if the guarantee is expressed to be a continuing guarantee) if, for example, it comprises "an act done once and for all by the persons to whom the guarantee is given."[41] This lends support for the views expressed in some text books,[42] that if in reliance on the guarantee the creditor has entered into a transaction with the principal debtor which is irrevocable, the guarantor has no right to terminate the guarantee because to do so would inevitably prejudice the creditor. But it is different if the creditor can terminate his transaction with the principal debtor, because if the guarantee is terminated the creditor can decide whether to continue the transaction with the principal debtor or not.

43. Very often a guarantee of a continuing facility, such as a current account overdraft facility, will expressly confer on the guarantor a right to terminate the guarantee. There are two ways to achieve this. The first is to include an express provision enabling the surety to give notice of termination of the guarantee so that the creditor is given a period of time within which he may if he chooses make a demand on the guarantor, and if he chooses not to do so the contract wholly comes to an end. The alternative is to have a provision which enables the guarantor by the service of notice to bring an end to the continuing character of the guarantee so that from expiry of the notice its subject matter becomes the obligations of the principal debtor to the creditor at that time,[43] unless and until they are subsequently repaid. Here are two illustrations.

44. In ***National Westminster Bank plc v Hardman***[44] the guarantees provided as follows.

> "This guarantee shall be a continuing security and shall remain in force notwithstanding any disability or the death of the guarantor until determined by three months' notice in writing from the guarantor or the personal representative of the guarantor" … [but the guarantor would continue to be liable for] "amounts due hereunder at the termination".

45. When the guarantor's notice expired, the principal debtor companies owed more than the limit of the guarantees, but the bank had not made demand on the companies. Demand was only made on the principal debtor companies at a much later date. The Court of Appeal accepted the guarantor's argument that he had no liability under the guarantee because in the absence of demand, the principal debtor companies owed nothing to the bank at the date when the notice to terminate the guarantee had expired and the guarantee came to an end.

46. The decision in Hardman has been questioned,[45] and some earlier authority suggests that on the expiry of notice the guarantor remains liable in respect of the borrowing as it then stands.[46] But the distinguishing feature of the Hardman case is that the guarantee provided for the guarantor only to be liable for sums "due" under the guarantee "at termination". That can be

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[39] See BCCI *SA v Simjee* [1997] CLC 135 at 138.
[40] See *Coulthart v Clementson* (1879) 5 QBD 42 at 46.
[41] *Lloyd's v Harper* (1880) 16 Ch D 290 at 317 (where the consideration a guarantee of a son's Lloyd's liabilities, was the son's admission to Lloyd's which was irrevocable).
[42] For example in Chitty on Contracts 30th ed (2008) para 44-017.
[43] BCCI *SA v Simjee* [1997] CLC 135 at 138.
[44] [1988] FLR 302.
[45] See Paget's Law of Banking 13th ed 2007 para 33.28.
[46] See for example *Thomas v Nottingham Inc. F.C. Ltd* [1972] Ch 596 at 600, cited with approval in *National House Building Council v Fraser* [1983] 1 All ER 1090; see also National Westminster Bank Ltd v French (Unrep) 20 Oct 1977.

compared to the terms of the guarantee in issue in ***Bank of Credit & Commerce International SA v Simjee***.[47] There the circumstances were similar, but the guarantee provided that:

> "This guarantee is to be a continuing security … but may and shall be determined (save as provided below) and the liability hereunder crystallised (except as regards unascertained or contingent liabilities and the interest charges costs and expenses hereinbefore referred to) at the expiration of three months after the receipt by you from the undersigned of notice in writing to determine it …"

47. The Court of Appeal held that this clause fell within the second category of case – that is to say what the notice determined was not the guarantee as a whole, but just the continuing nature of the guarantee, so that the guarantor remained liable under it for the obligations of the principal debtor at that date even if those liabilities had not themselves been crystallised by demand on the principal debtor.

48. In order not to fall into the same trap as the bank in Hardman, it therefore needs to be made clear that termination does not affect the guarantor's contingent liability in respect of advances made to the principal debtor prior to the expiry of the guarantor's notice of termination.

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September 2009

[47] [1997] CLC 135, CA.