An introduction to contracts of guarantee

If you leave me, can I come too?

Miles Crawley

5 March 2013

Contents

- the differences between guarantees, indemnities and warranties and the legal significance of a contract being categorised as a guarantee.
- advising a proposed guarantor;
- attempting to enforce a guarantee;
- defending a claim made under the guarantee;
- considering some statutory provisions and cases.

Guarantee v indemnity

Both guarantees and indemnities secure the performance of an obligation

- guarantee does so by way of a secondary liability whereas an indemnity does so as a primary liability
- Thus liability under an indemnity is not dependent upon the continuing liability of the principal promisor but is a promise by one party to a contract to keep the other harmless against loss, even if the principal is not in default.

The significance of the distinction in practice

- guarantees generally are required to be evidenced in writing whereas indemnities are not;
- guarantor's liability will be affected by the enforceability of the liability of the principal far more so than an indemnifier's;
- a guarantor's liability is far more likely to be discharged by certain types of conduct of the creditor

Whether a contract is one of guarantee or indemnity is a question of construction in each case.

Total Oil Products (Aust) Pty Ltd v Robinson [1970] 1 NSWR 701

Yeoman Credit Ltd v Latter [1961] 1 WLR 828 at 833

Citicorp Australia Ltd v Hendry (1985) 4 NSWLR 1 at 20

Guarantee v warranty

- The term guarantee should be used to describe a collateral contract where one party promises to another the due fulfilment of an obligation by a third party.
- The term warranty should be limited to promises that the subject matter of a contract is as it appears or has been represented
- But see building guarantees and consumer guarantees

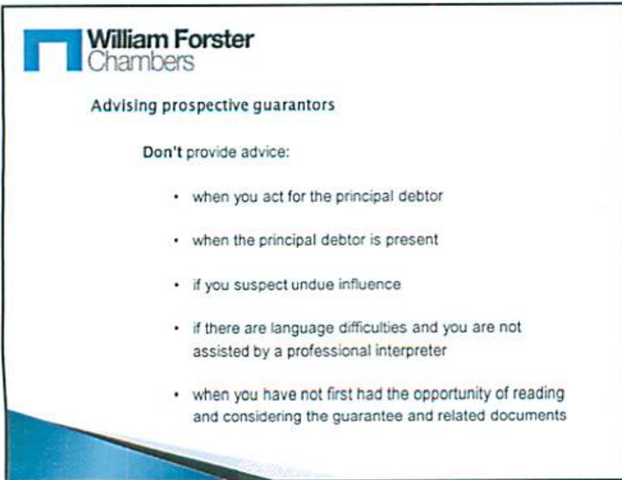
Guarantee v simple contract

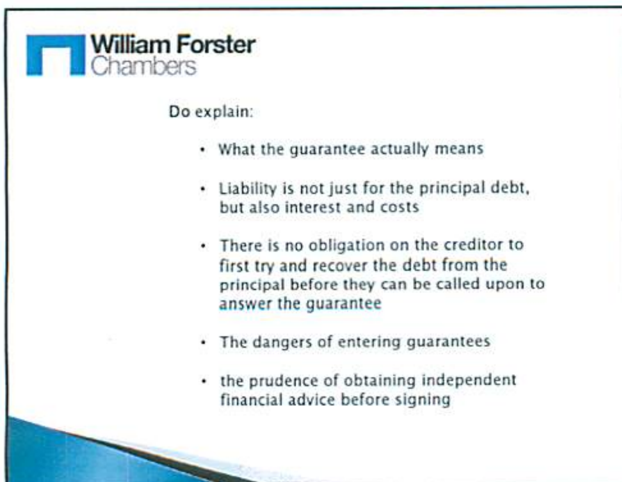
- Privity of contract applies to contracts of guarantee. A plaintiff cannot enforce a guarantee at law unless it was a party to the contract of guarantee. Thus, for example, a landlord cannot enforce a third party's written undertaking addressed to the tenant to be responsible for the rent *Nash v Spencer* (1896) 13 TLR 78
- Unless the contract of guarantee is under seal, it must be supported by consideration (subject to the possible application of the doctrine of estoppel)

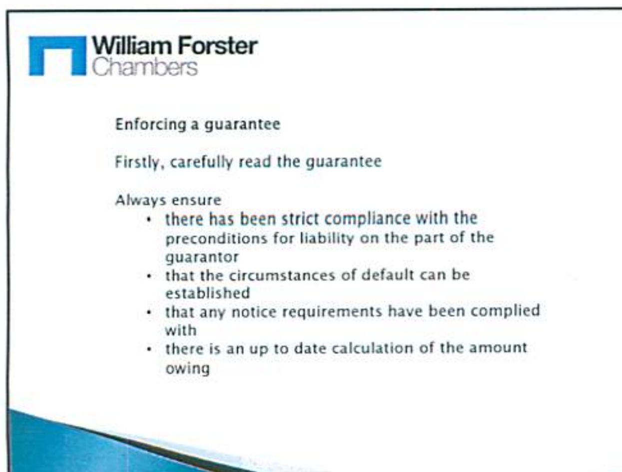
- Ambiguity in guarantees will be construed in favour of the guarantor (Ankar Pty Ltd v National Westminster Finance (Australia) Ltd (1986-7) 162 CLR 549 at 561).

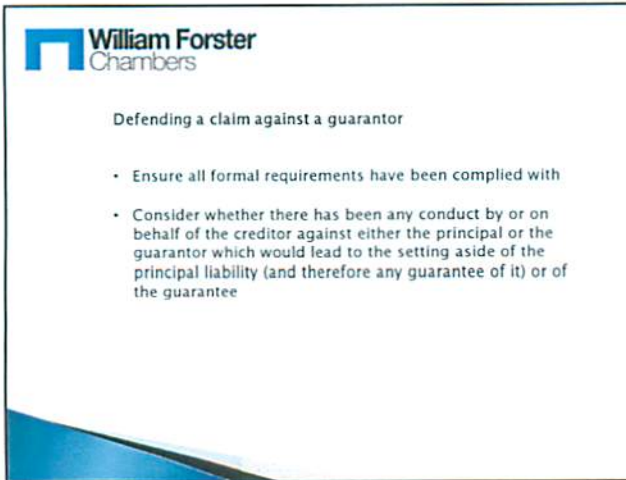
"For a clause to be ambiguous, the Court must be satisfied that the alternative construction relied upon still has merit after having regard to the ordinary meaning to be attributed to the words used considered in the context of the whole of the document, and after having regard to the surrounding circumstances" (Hilder v Garraway & Bunnings Building Supplies Pty Ltd [1994] NTSC 54)

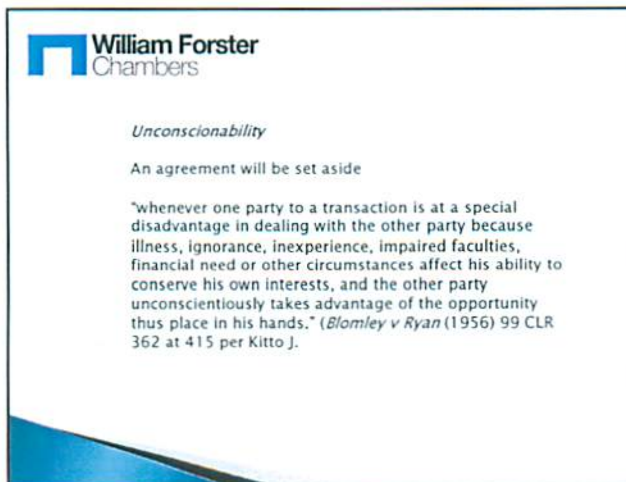
- Unlike a simple contract, generally to be enforceable contract of guarantee itself or some memorandum or note of it must be in writing and "signed" by the promisor (which can include by their name being printed with their authority *Leeman v Stocks* [1951] Ch 941) *Law of Property Act* , section 54. It is not necessary that the consideration appear on the face of the document.

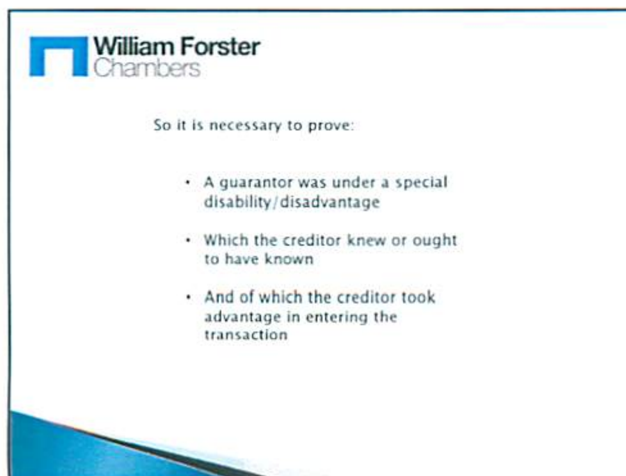

William Forster
Chambers
Advising prospective guarantors
Don't provide advice:
• when you act for the principal debtor
• when the principal debtor is present
• if you suspect undue influence
• if there are language difficulties and you are not assisted by a professional interpreter
• when you have not first had the opportunity of reading and considering the guarantee and related documents

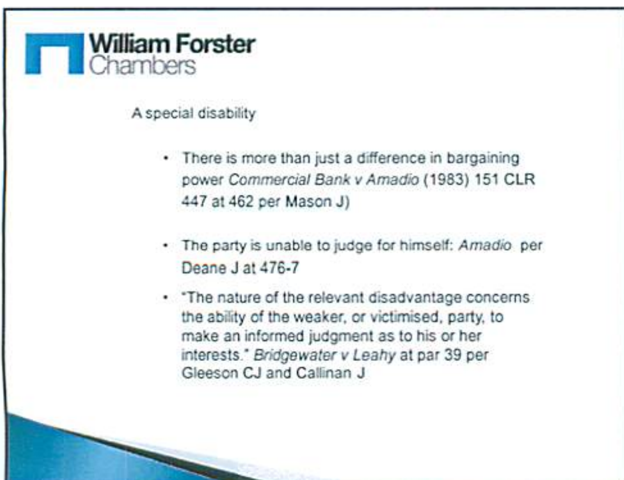

William Forster
Chambers
Do explain:
• What the guarantee actually means
• Liability is not just for the principal debt, but also interest and costs
• There is no obligation on the creditor to first try and recover the debt from the principal before they can be called upon to answer the guarantee
• The dangers of entering guarantees
• the prudence of obtaining independent financial advice before signing

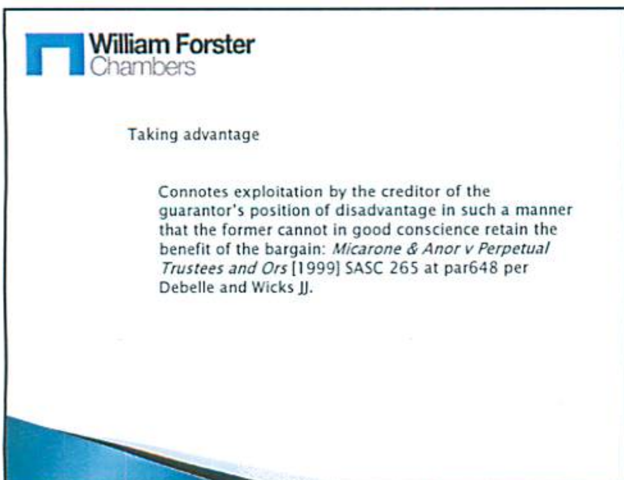

William Forster
Chambers
Enforcing a guarantee
Firstly, carefully read the guarantee
Always ensure
• there has been strict compliance with the preconditions for liability on the part of the guarantor
• that the circumstances of default can be established
• that any notice requirements have been complied with
• there is an up to date calculation of the amount owing

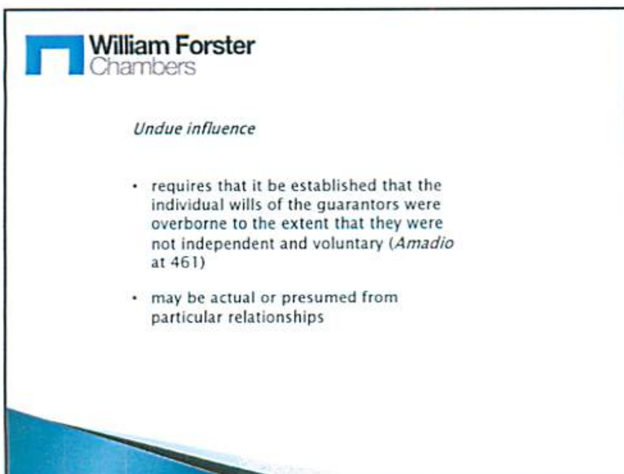

William Forster
Chambers
Defending a claim against a guarantor
• Ensure all formal requirements have been complied with
• Consider whether there has been any conduct by or on behalf of the creditor against either the principal or the guarantor which would lead to the setting aside of the principal liability (and therefore any guarantee of it) or of the guarantee

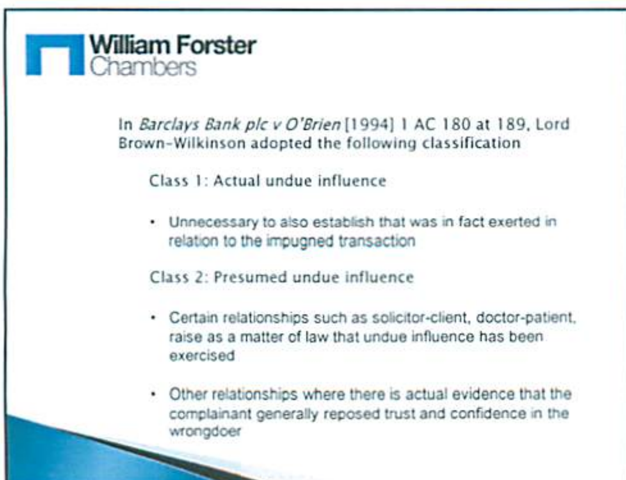

William Forster
Chambers
Unconscionability
An agreement will be set aside
"whenever one party to a transaction is at a special disadvantage in dealing with the other party because illness, ignorance, inexperience, impaired faculties, financial need or other circumstances affect his ability to conserve his own interests, and the other party unconscientiously takes advantage of the opportunity thus place in his hands." (Blomley v Ryan (1956) 99 CLR 362 at 415 per Kitto J.

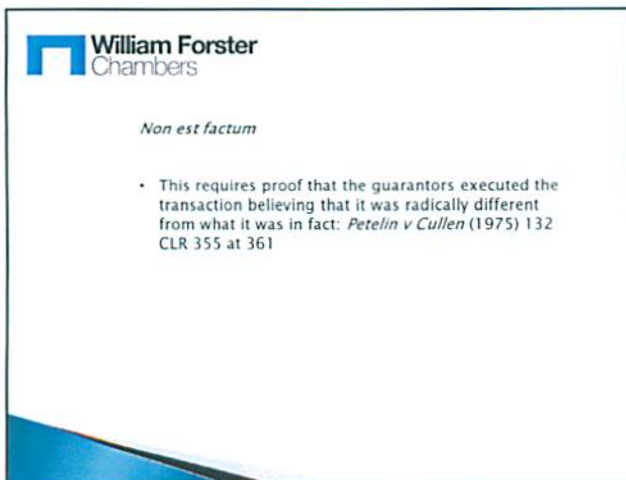

William Forster
Chambers
So it is necessary to prove:
• A guarantor was under a special disability/disadvantage
• Which the creditor knew or ought to have known
• And of which the creditor took advantage in entering the transaction

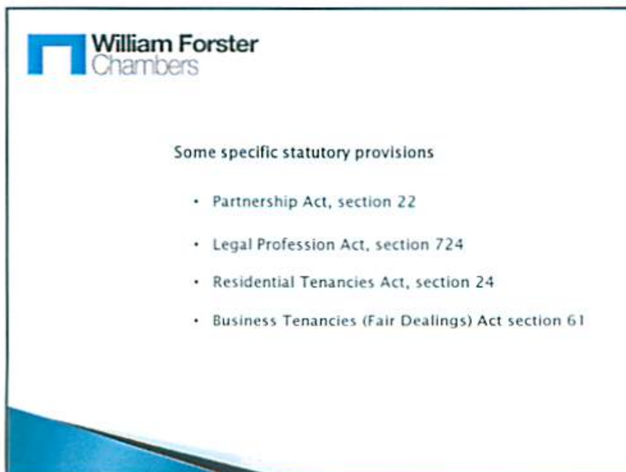

William Forster
Chambers
A special disability
• There is more than just a difference in bargaining power *Commercial Bank v Amadio* (1983) 151 CLR 447 at 462 per Mason J)
• The party is unable to judge for himself: *Amadio* per Deane J at 476-7
• "The nature of the relevant disadvantage concerns the ability of the weaker, or victimised, party, to make an informed judgment as to his or her interests." *Bridgewater v Leahy* at par 39 per Gleeson CJ and Callinan J


William Forster
Chambers
Taking advantage
Connotes exploitation by the creditor of the guarantor's position of disadvantage in such a manner that the former cannot in good conscience retain the benefit of the bargain: *Micarone & Anor v Perpetual Trustees and Ors* [1999] SASC 265 at par648 per Debelle and Wicks JJ.


William Forster
Chambers
Undue influence
• requires that it be established that the individual wills of the guarantors were overborne to the extent that they were not independent and voluntary (*Amadio* at 461)
• may be actual or presumed from particular relationships


William Forster
Chambers
In *Barclays Bank plc v O'Brien* [1994] 1 AC 180 at 189, Lord Brown-Wilkinson adopted the following classification
Class 1: Actual undue influence
• Unnecessary to also establish that was in fact exerted in relation to the impugned transaction
Class 2: Presumed undue influence
• Certain relationships such as solicitor-client, doctor-patient, raise as a matter of law that undue influence has been exercised
• Other relationships where there is actual evidence that the complainant generally reposed trust and confidence in the wrongdoer


William Forster
Chambers
Non est factum
• This requires proof that the guarantors executed the transaction believing that it was radically different from what it was in fact: *Petelin v Cullen* (1975) 132 CLR 355 at 361


William Forster
Chambers
Some specific statutory provisions
• Partnership Act, section 22
• Legal Profession Act, section 724
• Residential Tenancies Act, section 24
• Business Tenancies (Fair Dealings) Act section 61

Some case examples

- *Challenge Bank v Pandya & Ors* (1993) 60 SASR 330
- *Micarone & Anor v Perpetual Trustees & Ors* [1999] SASC 265

A footnote

Be careful what you wish for, because you might just get it