

## Time to pay up? Guarantees and Indemnities

### Part One - Guarantees

August 2020



Published by  
Rosalind Cullis

*Taking advantage of existing guarantees and indemnities may be an attractive option in the current market. Alternatively, parties to new leases and contracts may require guarantees or indemnities to get deals over the line. In these two articles, we highlight the practical impact of the differences between guarantees and indemnities. This first article looks at guarantees.*

#### What is a Guarantee?

A guarantee is a contractual promise by a guarantor to meet the obligations set out in the main contract if the principal party, who is contracted to meet those obligations, fails to do so. In the context of a lease, the guarantor agrees to meet the tenant's obligations if the tenant is in breach. A guarantee is known as a *secondary obligation* essentially because a guarantor's liability will never be greater than that of the principal party under the main agreement. If the principal party's liability is reduced or extinguished, the guarantor's liability is correspondingly reduced or extinguished. Also, if the underlying obligation is amended, the guarantee may be lost altogether.

Guarantees are strictly construed by the courts: guarantors are only liable to the extent they have agreed to be liable in writing (section 4 Statute of Frauds 1677) and any ambiguity will be interpreted in the guarantor's favour.

The Court of Appeal decision in *Golden Ocean Group Ltd v Salgaocar Mining Industries PVT Ltd* and another [2012] raised interesting issues in terms of the creation of an enforceable guarantee. It was held that an email chain which was not marked '*subject to contract*' but from which it was clear that the parties expected a formal document to be drawn up nevertheless created an enforceable guarantee. An email signature, even where only the first name, initials or a nickname is used, might also be sufficient to create a binding guarantee.

#### Landlord and Tenant

In a landlord and tenant context, the Landlord and Tenant (Covenants) Act 1995 has intervened to provide further protection to guarantors:

- A guarantee of a tenant's obligations under a lease granted on or after 1 January 1996 will end on lawful assignment, although the landlord may require the guarantor to take on a new obligation to guarantee the outgoing tenant's obligations in any authorised guarantee agreement (AGA) it enters into in relation to the assignee. An AGA is a specific type of guarantee under which an outgoing tenant gives a guarantee in relation to the assignee's obligations under the lease.

- A guarantor of a former tenant who has assigned a lease (whether pre or post 1 January 1996) will not be liable for arrears of rent and service charge unless it has been served with the relevant statutory notice within 6 months of the charge falling due. If the guarantor pays up having received the notice, it is then entitled to seek an overriding lease, which puts it back in control of the property (section 17).
- Once a lease has been assigned, a guarantor will generally not be liable to pay anything as a result of any lease variation agreed between the landlord and an assignee tenant (section 18).

Guarantors under leases may also be called upon to take a new lease of premises, for example where the tenant is insolvent. The landlord can enforce this obligation by seeking an order for specific performance.

Such a clause is effective even if the lease is disclaimed (following liquidation), unless the landlord takes back possession after disclaimer. This can happen inadvertently, so landlords must proceed with caution (for example when taking possession proceedings against squatters). Landlords should also consider whether any third party has occupied the premises since the tenant's insolvency, as this could create an argument that the landlord has accepted a surrender of the lease (thereby releasing a guarantor). This could occur if a third party takes up occupation and the landlord demands and accepts rent from them.

### Defending a claim

Aside from arguments about whether the parties complied with the formal requirements for creating a guarantee, the following may be fertile ground for the guarantor to dispute liability:

- The extent of the obligation – is the creditor claiming something that goes beyond the underlying obligation in the main contract?
- Substantial variation - any substantial variation of the main contract will release a guarantor who was not a party to it, whether or not the variation benefits the creditor.
- Undue influence and misrepresentation - was the guarantor misled about the transaction and the implications of acting as guarantor or forced to provide the guarantee?
- Release of security - where the creditor has released or compromised other security thereby prejudicing the guarantor, this may also release the guarantor.

### What if it is unclear?

Labelling a document (as a "guarantee" or an "indemnity", for example) is not conclusive. The courts will look at what the parties intended by the words they chose to use in the documents. In *Catalyst Business Finance v. Very Tangy Television Limited, Richard Tuckwell, Very Tangy Media Limited* [2018], the court found that the relevant document was a hybrid of different types of obligations, which could not all be enforced in the same way.

Read the second article in this series for a discussion of indemnities and how they are different from guarantees.