

# Broken English

Has a recent case unwittingly scrambled ancient laws of guarantee? Isaac Jacob reports

We learned at law school that a guarantee was unenforceable unless in writing. Section 4 of the Statute of Frauds 1677 provides (in modern English) that: "No action shall be brought... whereby to charge the defendant upon any special promise to answer for the debt default or miscarriages of another person... unless the agreement upon which such action shall be brought or some memorandum or note thereof shall be in writing and signed by the party to be charged therewith..."

But what if there is no writing? Or if the writing is so defective that it cannot – even by a generous construction – be brought within the terms of the statute? Can we evade the requirements of the statute by recourse to the doctrines of rectification or estoppel?

A recent example of just such an attempt is the decision in *Fairstate Limited v General Enterprise* [2010] EWHC 3072 (QB). Fairstate owned a block of flats and entered into a management agreement with Sarian's company, GEML, to manage it. Sarian was not a party but signed the agreement as director of GEML. It set out the proposed guarantee perfectly clearly in the recitals: "[Fairstate] wishes to engage [GEML] and to delegate certain of his [sic] powers in respect of the property to [GEML] under the terms and conditions set out in this agreement in respect of the ten flats at the property and where [GEML] through its director Mr Atef Sarian is willing to provide a personal guarantee against any possible loss or damage to [Fairstate] copy of which is appended herewith."

Sarian signed a document which was intended (as the judge found) to guarantee GEML's liabilities but was almost unbelievably badly drawn. Among other defects, Sarian seemed to be guaranteeing himself, the principal debtor was named as Fairstate instead of GEML and a bank guarantee form was used which was wholly inappropriate to the transaction into which the parties were entering. GEML defaulted and Fairstate sued Sarian as guarantor.

He raised the absence of writing as a defence. In response, Fairstate asserted that the guarantee was rectifiable to give effect to



the true intention of the parties as contained in the recital to the management agreement alternatively that Sarian was estopped from denying that he had entered into a guarantee.

The judge accepted that both estoppel and rectification were available to Fairstate, but that: (i) Sarian was not estopped as he was not a party to the management agreement and there was no available representation; and (ii) the guarantee was not rectifiable as there was uncertainty as to what exactly the parties had agreed.

The judge's acceptance that a guarantor could be liable even though there was no written agreement or the written agreement did not come within the terms of the statute raises a conceptual problem with which courts have grappled for a number of years. How is it possible to get around the absence of any writing at all or any writing in accordance with the statute? Is this not effectively a judicial repeal of the statute?

## Look twice

There is no case where an estoppel has taken the place of a sufficient note or memorandum. However, textbooks and a House of Lords authority suggest that, in some circumstances, an estoppel can replace the writing required by the statute. In what circumstances?

Analysis of the cases shows that the only situation where a guarantor may be estopped from relying upon the statute is where, by

reasons of his representations or actions upon which the creditor relied, the court will not look into the validity or invalidity of the guarantee.

In *Humphries v Humphries* [1910] 2 KB 531, a tenant was sued by his landlord for arrears of rent. He could have argued there was no liability because the tenancy agreement was not in writing as the statute then required; however, he merely contested the existence of an agreement – and lost.

In a subsequent action for further arrears, he sought to raise the statute as a defence. He was held to be estopped. Examination of the reasoning in the divisional court indicates that he fell foul of the rule in *Henderson v Henderson* in that he failed to raise an available defence in the first action. The Court of Appeal decided the matter on the basis of issue estoppel. The question of the validity of the agreement was closed off. The court refused to look at the validity or invalidity of the guarantee.

In *Bank of Scotland v Wright* [1991] BCLC 244, a director had given a bank guarantee in favour of his company. The bank maintained that the guarantee applied also to the liability of a subsidiary company. As a matter of construction, the court held that it did and on this basis the bank succeeded. However, the bank also raised estoppel, arguing that the parties had treated the guarantee as extending to the subsidiary and the director was estopped from raising the statute.

Brooke J accepted that an estoppel by convention might arise but could see nothing unconscionable in the director's reliance on the statute. He did not exclude the possibility that in other circumstances such unconscionability might be shown. Clearly it cannot be unconscionable for the guarantor to rely upon the statute, and if that is all that has happened he cannot be estopped.

What further unconscionability is required? It cannot matter whether it is more or less unconscionable to rely upon the statute. If such reliance is statutorily permitted – as it clearly is – that must be the end of the inquiry.

What is required is a separate or extraneous factor raising unconscionability which makes unnecessary any inquiry into the absence or presence of the requirements of the statute. On this basis the creditor is not pursuing an action to enforce a guarantee which runs foul of the statute. There is instead an action to give effect to an equity which arises upon a separate estoppel and which closes off the question whether the guarantee does or does not comply with the statute.

In *Actionstrength Ltd v International Glass Engineering SpA* [2003] AC 541, the House of Lords had to consider what separate or extraneous factor might preclude a consideration of the validity or invalidity of the guarantee – and therefore whether or not there was compliance with the statute. The lords agreed that the representation to the creditor by the guarantor that the creditor was entering into a valid guarantee despite non-compliance with the statute was insufficient.

Some of the lords did indicate the type of matter which might preclude a consideration of whether the agreement did or did not come within the statute.

Lord Bingham suggested that such a case might arise where “there was [a] representation by [the guarantor] that it would honour the agreement despite the absence of writing, or that it was not a contract of guarantee, or that it would confirm the agreement in writing”, or if the guarantor were to make “any payment direct to [the creditor] which could arguably be relied on as affirming the oral agreement or inducing the creditor to go on supplying labour” or further finance.

Lord Walker suggested that an “explicit assurance that [the guarantor] would not plead the Statute of Frauds (like an explicit assurance not to take a limitation point) could found an estoppel”. It is clear that the promise or representation inherent in the guarantee itself is insufficient. There has to be a separate representation by the guarantor upon which the creditor relied so that there

was a change of position or it would otherwise be unconscionable to allow the guarantor to resile. In *Fairstate* there was no separate or additional representation and this was also a ground for refusing to accept that the creditor was estopped.

The circumstances in which such additional or separate representation might be given must be few and far between. It is only if the creditor has reason to suspect that the guarantee is invalid that an additional assurance might operate upon his mind – otherwise any additional credit or advantage to the debtor would simply be referable to the creditor's belief in the validity of the original guarantee.

**“There appears to be no reported case where a creditor, faced with a guarantee which does not satisfy the statute, has successfully sued the guarantor”**

If the creditor does have reason to suspect that the guarantee is invalid, he is far more likely to require the guarantor to enter into a valid form of guarantee rather than rely upon some additional assurance by the guarantor. Apart from *Humphries*, and despite general acceptance of the efficacy of estoppel, there appears to be no reported case where a creditor, faced with a guarantee which does not satisfy the statute, has successfully sued the guarantor.

**Rectification**

It has long been accepted that rectification was available in the case of contracts relating to land. Such contracts, like guarantees, were required to be in writing first by the statute and then section 40 of the Law of Property Act. Textbook writers generally took the view that there was no sensible distinction that could be made between contracts of guarantee and contracts relating to land.

The matter arose for decision directly in *GMAC Commercial Credit Development Ltd and Kalvinder Singh Sandhu and Kewal Singh Sandhu* [2004] EWHC 716 (Comm). The guarantors argued that to permit rectification to create a valid guarantee where none otherwise existed would breach the requirement of the Statute of Frauds that there was no English authority and cases relating to land were distinguishable as contracts of guarantee were peculiarly onerous and presented different policy considerations.

The judge relied upon a New Zealand decision, *Whiting v Diver Plumbing and Heating Ltd* [1992] 1 NZLR 560, where the principles upon which rectification of

a guarantee could be granted were considered. In fact (had the decision been cited to him) the judge might have relied upon the high persuasive authority of the Privy Council in *Donovan Crawford and others v Financial Institutions Services Limited*.

In this appeal from the Jamaican Court of Appeal, delivered on 19 June 2003, Lord Hutton stated: “Rectification and enforcement, while available in the same proceedings, are two distinct steps. The first step is for the court to determine whether the instrument in question ought to be rectified, and the second and separate step is to determine whether the instrument in its rectified form is enforceable.”

The statute bites upon enforcement of the agreement: “No action shall be brought.” Rectification (if appropriate) takes place at a notionally earlier and separate stage. If the agreement as rectified comes within the statute, there can be no reason in principle why it should not be enforced.

In *Fairstate*, the judge held that there had been no agreement as to comparable detailed clauses which might have gone into the guarantee. In this respect he may well have fallen into error. All that the parties had agreed was a very simple form of guarantee as set out in the recital whereby Sarian had agreed to guarantee Fairstate against any loss or damage it might suffer by reason of GEML's breach of the management agreement.

That was all that needed to be in the written document. Everything else was added by the common solicitor who used a completely inappropriate form. It remains to be seen whether Fairstate will appeal.

The only estoppel which will avail a creditor is one which precludes consideration of whether a guarantee complies with the statute – whether by reason of issue estoppel, abuse of process or the raising of some equity independent of any equity that the promise of a guarantee would otherwise raise.

Rectification of a guarantee does not involve its enforcement and accordingly the statute does not bite upon this process. If the agreement as rectified complies with the requirements of the statute, there can be no objection to its enforcement.

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Isaac Jacob is a barrister at 9 Stone Buildings, Lincoln's Inn